

THE INCOME TAX REPORTS

A JOURNAL OF THE LAW OF INCOME TAX

WITH REPORTS OF
INDIAN AND SELECT ENGLISH CASES

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PART I.

NOTES AND COMMENTS.

The New Year.

The new year marks the beginning of a new epoch in the administration of the law of income tax in India. The entire law as embodied in the Act of 1922 has been carefully considered in the light of experience by a Committee of experts. Representations of the various commercial institutions and local governments of India on the recommendations of this Committee have been received, and the Central Government are preparing a Bill on the lines of the Report and the opinions received from the public. The Bill is expected to be introduced in the Legislative Assembly very shortly and the Act as entirely overhauled is expected to come into force in the new year. We shall closely watch the progress of the proposed legislation and review the same in these columns.

Judicial Committee on Assessment of Income From Business.

The recent decision of the Judicial Committee in *Commissioner of Income Tax, Bombay v. Sarangpur Cotton Manufacturing Co. Ltd.*, (reported below at p. 36) lays down certain general propositions of considerable importance relating to the duties of Income Tax Officers in computing the income of an assessee from business. Sec. 13 of the Act, it will be remembered, provides that the income, profits and gains shall be computed for the purposes of Secs. 10, 11 and 12 in accordance with the method of accounting regularly employed by the assessee and that, if no method of accounting has been regularly employed or if the method employed is such that, in the opinion of the Income tax Officer the true income, profits or gains cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income tax Officer may determine. Their Lordships have laid down the following points in connection with the application of this section—

(1) The section relates to a method of accounting regularly employed by the assessee for his own purposes and does not relate to a method of making up the statutory return for assessment to income tax :

(2) Secondly, the section clearly makes such a method of accounting a compulsory basis of computation, unless in the opinion of the Income tax Officer, the income, profits and gains cannot properly be deduced therefrom. Even if the accounts be complicated, if it is possible to deduce the true profits from the accounts, the judgment of the Income tax Officer must be properly exercised. This is not a discretionary power of the Income tax Officer but a statutory duty imposed on him.

(3) The third important point decided is that the Income tax Officer is not entitled to pin the assessee down to the profits shown in his accounts where he has employed a regular method of accounting. Where such a method is employed, it is the duty of the Income tax Officer to consider whether the income, profits and gains can be properly deduced therefrom and to proceed according to his judgment on the question.

In the case before their Lordships the assessees employed a regular method of accounting but had also adopted regularly a method of valuation of stock by taking some price under both cost and market price with the object of creating a 'secret' reserve, which involved the retention of profits so as not to be included in the profits shown to the shareholders. For the account year 1930 the assessees submitted their profit and loss account showing a profit of Rs. 2,64,086 and a return of the total income of the company showing an income of Rs. 1,99,086 which was arrived at by taking into account the result of the undervaluation of stock which the company had adopted in the previous years. The Income tax Officer, without considering whether the true income could be arrived at from the method of accounting employed by the assessees, held that the assessees were bound by the profit shown in the balance sheet. The Privy Council held that the Income tax Officer was not entitled to take the profits shown in the balance sheet as the real income of the assessees but was bound to consider whether the true income could be deduced from the account of the assessees and to proceed according to his judgment on this question.

Loans and Capital Investments.

A very interesting case of the Nagpur High Court, which shows the difficulty of distinguishing between an investment by way

of loan in the course of a business and an investment to acquire new business is reported* at page 10 *infra* as *Commissioner of Income Tax, C. P. and U. P. v. Motiram Nandram*. The assessees who were money-lenders deposited Rs. 50,000 with an Oil Company under a contract by which they were appointed sole organising agents of the company for a certain area. The assessees were to recommend selling agents and to recoup their deposit from the deposits made by the selling agents. The deposit carried interest at 7 per cent per annum and the assessees further received a commission on all sales effected by the company direct or through the selling agents. The company went into liquidation and the assessees were unable to recover a major portion of the deposit. There was conflict of opinion between the Judges who heard the case on the question whether the sum of Rs. 50,000 advanced by the assessees was a loan made in the course of their business, or an investment of capital to acquire a new business. The view which ultimately prevailed with the Nagpur High Court was that the deposit was in the nature of a loan made by the assessees in the course of their business out of their floating or circulating capital and that the loss incurred was therefore allowable as a trading loss in computing their income. The dissenting Judge agreed with the Commissioner's view that the deposit was money invested in acquiring a new business and being in the nature of a capital expenditure, could not be allowed. Much depends in such cases on the view which we take of the facts of the case and it is impossible to express any opinion in such cases from a purely legal point of view.

Objections as to Jurisdiction of Income Tax Officers.

The Allahabad High Court has, in *Seth Kanhaiya Lal v. Commissioner of Income Tax, U. P.* [1937 I. T. R. 739] made some pronouncements on objections as to the territorial jurisdiction of Income Tax Officers which deserve to be brought to the notice of Income Tax Officers and assessees. After a careful consideration of Secs. 64 and 30 of the Indian Income Tax Act, their Lordships have held in this case that—

(1) Under Section 30 of the Act an assessee has a right of appeal only as regards his liability to be assessed under the Act or as regards the amount or rate at which he has been assessed. He cannot raise an objection as to the place of assessment for the first time in appeal.

(2) Even if he raises the point in appeal and it is considered by the Assistant Commissioner, the question cannot properly be said to arise out of the appellate order and there can be no reference to the High Court in respect of such question.

(3) Questions relating to the territorial jurisdiction of Income Tax Officers must be raised at the earliest possible stage before the Income Tax Officers themselves and they have to be decided by the Commissioner or the Central Board of Revenue and their decision is final.

Interest Received By Partner : Whether Exempt From Tax.

In *Seth Kanhaiya Lal's Case* [1937 I.T.R. 730], the Allahabad High Court has decided a question relating to partnerships which deserves notice. Under Sec. 14 (2) (b) of the Indian Income Tax Act, tax is not payable by an assessee in respect of such an amount of the profits or gains of any firm which have been assessed to income tax as is proportionate to his share in the firm at the time of assessment. Interest payable to partners by the firm is not allowed to be deducted in computing the income of the firm. It is treated as income of the firm. Where such interest is accordingly taken into account in computing the income of the firm, but in consequence of losses which absorb the whole profits, the firm is not taxed at all, are the partners entitled to claim exemption under Sec. 14 (2) (b) in respect of the interest received by them? The Allahabad High Court has answered the question in the negative in the above mentioned case. Their Lordships hold that the income made by the partners on the head of interest received from the firm can be exempted under Sec. 14 (2) (b) only if the firm had made certain profits and those profits *had been assessed* to income tax. Profits, in their Lordships' view, can be said to be assessed to income tax only when an order has been made by the department determining the sum payable by an assessee as income tax and not when calculation only of the profits and losses have been made. When losses absorb the profits and no tax is levied on the firm, there is no double taxation and the interest received by the partners is not exempt under Sec. 14 (2) (b). The question is not free from difficulty and we shall revert to this subject later on.

Co-owners as an Association of Individuals.

The Bombay High Court has recently extended its view that co-owners of immoveable property can be assessed as an association

of individuals, to persons inheriting property under a will as tenants-in-common in definite shares and enjoying the income thereof in their respective shares. [See *Dwarkanath Harischandra Pitale, In re*, 1937 I.T.R. 716]. The learned Judges hold the view that in such cases though the assesseees in the first instance do not constitute an association, they become as association of individuals within the meaning of Sec. 3 of the Act when they elect to retain the property and manage it as a joint venture producing income. We have already adverted to this subject on several occasions and the only comment which we have to make is that in none of the cases hitherto decided has the Bombay High Court considered whether cases in which the income is owned and appropriated in separate shares, by the co-owners do not stand on a different footing from cases where the income is not so owned and enjoyed in definite shares. This seems to be a vital point to which the Income Tax Enquiry Committee have drawn pointed attention, and we trust that when the question arises again before the Bombay High Court, the distinction between these two sets of cases would be brought to the notice of the Judges for their consideration.

Re-assessment : Necessity of Amending Sec. 34.

In a recent judgment of the Judicial Commissioner's Court of Sind, *Commissioner of Income-tax, Bombay v. Lokumal Bhojmal*, Ref. No. 152 of 1935 (to be reported shortly), Rupchand Bilaram, A. J. C., has rightly dwelt upon the vague and indefinite wording of Sec. 34 of the Indian Income Tax Act. "It is rather unfortunate," says the learned Judge, "that Sec. 34, unlike the corresponding section of the English Act, does not specifically refer to the cases in which the Income Tax Officers may take action, and the words 'escaped assessment' are somewhat vague and indefinite." Every one who has been following the course of the decisions on Sec. 34 of the Act and the irreconcilable conflict of judicial opinion on the interpretation of the words 'escaped assessment', would endorse the opinion of the learned Judge, and, as Sec. 34 has to be resorted to by Income Tax Officers very often, we would earnestly draw the attention of the Central Board of Revenue to the remarks made by the learned Judge and to the necessity of specifying more clearly the cases in which a re-assessment could be made. This section may be re-drafted on the lines of the corresponding section of the English Act, namely, Sec. 125, with necessary modifications.

CONVERSION OF HINDU UNDIVIDED FAMILY INTO FIRM.**MADRAS VIEW.**

[*Thontepu Chinna Pullayya's Case*, 1937 I.T.R. 132].

The question whether, when the members of a Hindu undivided family separate and form themselves into a firm, assessment is to be made on the members under Sec. 25-A of the Act on the total income of the joint family as such holding each member liable for his proportionate share of the tax, or whether the firm is to be assessed under Sec. 26 (2) as the successor of the Hindu undivided family is a very vexed one. The Madras High Court decided in *Thontepu Chinna Pullayya's Case* [1937 I.T.R. 132] that where the firm consists of exactly the same individuals as the previous joint Hindu family, there is no succession and assessment should be made under Sec. 25-A.

LAHORE VIEW.

[*Mittar Chand Lakhmi Das's Case*, 1937 I.T.R. 127]

A Full Bench of the Lahore High Court (JAI LAL, MONROE and ABDUL RASHID, JJ.) took an entirely different view in *Mittar Chand Lakhmi Das v. Commissioner of Income Tax, Punjab* [1937 I.T.R. 127 ; I.L.R. 1937 Lah. 189]. They held that where the members of a Hindu undivided family separate but form themselves into a firm and continue the family business, the firm is assessable under Sec. 26 (1) of the Indian Income Tax Act in respect of the business which was being carried on by the family in the previous year. In their Lordships' view Sec. 25-A contemplates cases where there is disruption of a Hindu undivided family but no continuance of the business either by the members of the family on a contractual basis or by some of them alone, or jointly with others or even by strangers. Where the business is continued, Sec. 26 will apply and the fact that the business is continued by all the members of the family and not by some of them alone will not render Sec. 26 inapplicable. This case was decided on the 23rd November 1936, but unfortunately the Madras case which was decided on the 31st March 1936, was not brought to their Lordships' notice.

Ram Rakha Mal's Case.

[1937 I.T.R. 137 : I.L.R. 1937 Lah. 325].

A month later, the Lahore High Court took the same view in a well considered judgment in *Ram Rakha Mal & Sons'*

Case [1937 I.T.R. 137]. Following *Mittar Chand's Case* their Lordships expressly held that Sec. 25-A of the Indian Income Tax Act applies only to those cases where the question involved is one of pure and simple disruption of a Hindu undivided family unattended by conversion, or transformation into a new entity, that Sec. 26 was intended to cover all cases which are specified in clauses (1) and (2) thereof in whatever way the situation envisaged there may arise, and that therefore, if in place of a Hindu undivided family a new firm is constituted or a new company is brought into existence, assessment should be made in accordance with Sec. 26 and not under Sec. 25-A. Referring to the Madras case of *Thontepu Chinna Pullayya* they said: "with all respect we are not prepared to endorse this opinion".

A RECENT BOMBAY DECISION.

Jesingbhai Ugarchand's Case.

In these circumstances the recent decision of the Bombay High Court in *Jesingbhai Ugarchand's Case* [1938 I.T.R. 25] will be read with much regret. The omission of the assessee's counsel to bring to the notice of the Judges the series of cases in which a view contrary to that of the Madras High Court was held, has evidently misled the Judges and left them to adopt a course which they would never have taken if the counsel had been more diligent.¹ The Judgment in *Jesingbhai's Case* proceeds entirely on the view that the only authority on the subject is the Madras case. The learned Judges after referring to the Madras case say :

"It is clearly not desirable that conflicting decisions under the Act which applies to the whole of British India should be given by different High Courts on exactly similar facts, and we propose therefore to follow the Madras case, without expressing any opinion of our own".

It is indeed a matter for regret that the decisions to the contrary which are reported even in the official reports published by the Government should not have been brought to their Lordship's notice by the counsel engaged in the case. The decisions are reported side by side in Part IV of Vol. V of the Income Tax Reports. If their Lordships had followed the Madras case for any other reason, the decision in *Jesingbhai's Case* would have been of some authority. But as it now stands, it is based on a misapprehension and is not of much weight as a precedent.

Casual and Non-recurring Receipts.

We have a good instance of a casual and non-recurring receipt in the case of *Mohammad Faruq, In re* [1938 I.T.R. 1]. The case is an important one as the line which distinguishes it from a case like that of *Gayaprasad Chotey Lal, In re*, [1935 I.T.R. 177] is rather narrow. An employee of a person who owned a sugar factory and wanted to convert it into a limited company, sold a large number of shares of the company, and the company voluntarily allotted Rs. 15,000 worth of shares to him in recognition of his services. It was found that this employee was not a promoter of companies or share-broker by vocation and there was also no previous agreement or understanding to pay him anything for his services. It was held that the receipt was a casual and non-recurring receipt not arising out of business and was exempt from being taxed. After referring to the definition of income laid down by the Privy Council in *Shaw Wallace & Co.'s Case*, their Lordships said that the receipt in question was in the nature of a wind-fall. It was casual in its nature and did not also arise from any business carried on by the assessee. 'Business', their Lordships said, must be some activity which has for its object the acquirement of some profit which can be claimed as of legal right.

It is instructive to compare the case of *Gayaprasad Chotey Lal*, in which the activity of the assessee was held to come within the term 'business'. There the assessee agreed to advance moneys for the prosecution of a litigation in consideration of the borrower paying a lump sum of money to the assessee over and above the loan advanced if the litigation was successful, and the assessee received Rs. 15,000 under the agreement. It was held that the transaction amounted to a business and the receipt represented a return on money invested in business. This case is distinguished in *Mohammad Faruq's Case*. Referring to this case their Lordships said :

"We must not be understood to say that a single transaction of a business nature, such for instance as a money lending transaction which resulted in gain would not justify the assessment of income upon that gain, but a transaction of that kind would clearly come within the meaning of the term 'business' and consequently it would not matter whether it was or was not of a casual and non-recurring nature. The facts of the case before us are entirely different".

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PART II.

NOTES & COMMENTS.

Assessment of Insurance Companies: Allowance for Depreciation of Securities.

A judgment of some importance to insurance companies has been pronounced by the Bombay High Court in *The Western India Life Insurance Co. Ltd., In re* (reported at p. 44 *infra*). Under the Indian Income Tax Act, ordinarily no deduction is allowed in respect of any depreciation in the value of securities or assets held by an assessee, as this is regarded as a capital loss. With regard to insurance companies, however, there is a special provision in Rule 30 of the Income Tax Rules that :

“Any amount either written off in the account or through the actuarial valuation balance sheet to meet depreciation of, or loss on securities or other assets, or which is carried to a reserve fund formed for that sole purpose and not used for any other purpose, may be treated as expenditure incurred solely for the purpose of earning the profits of the business”.

The question that arose for decision in the *Western India Life Insurance Co.'s Case* was this: where for some years there is a depreciation and amounts are carried to the reserve fund to meet that depreciation, can the company treat those sums as expenditure incurred solely for the purpose of earning the profits of the business under Rule 30 when there is an appreciation in the subsequent years, without giving credit for this appreciation; in other words, whether the company is bound to bring back the sums so reserved when there is an appreciation in a subsequent year which wipes off the previous loss.

It was strenuously argued on behalf of the Commissioner that the words ‘may be treated as expenditure’ in Rule 30 confer a discretion on the income tax authorities to treat the sums so reserved, as business expenditure or not, and that in circumstances like the present they would be properly exercising that discretion in not allowing such sums to be deducted as business expenditure.

The learned Judges of the High Court did not agree with this contention. They said that though the word ‘may’ is permissive, it is perfectly plain that it confers an option on the assessee, that is to

say, the word is used to confer a right on the assessee to treat the sum in that way, and that where sums are properly placed to the reserve fund there is nothing in the rules which requires the assessee to bring them back to the revenue account as soon as the depreciation which they were designed to meet has been made good.

The Advocate-General pointed out to the Court that serious consequences may follow on this interpretation of Rule 30, because large sums may be placed in reserve on which tax will not be paid. But their Lordships said that the two circumstances that sums can be so placed in reserve only for depreciation or loss which has already occurred and that the reserve fund can be used for no other purpose, were sufficient safeguards against improper evasion of tax.

The Judicial Committee on Assessment of Non-Residents.

In *The Commissioner of Income Tax, Punjab v. Nawal Kishore Kharaiti Lal* [reported at p. 61 *infra*] the Judicial Committee have made some pronouncements of general importance relating to the assessment of non-residents. In the judgment appealed from (reported at 1935 I.T.R. 350) the Lahore High Court had held that a notice under Sec. 22 (2) of the Income-tax Act calling for a return of income cannot be validly issued to a person as agent of a non-resident until an order declaring him to be agent of the non-resident in question has been previously made. The Judicial Committee have overruled this view and state the law on the point in these words :

“ The first question for decision is whether by the terms of the Act it is necessary to the validity of a notice calling for a return of income under Sec. 22 (2), where it is served upon a person as agent of a non-resident under Sec. 43, that it should have been preceded, not only by the notice of intention prescribed by Sec. 42 and by the opportunity of being heard prescribed by the proviso thereto, but also by an order to the effect variously described by the High Court as “ declaring the petitioner to be the agent of a non-resident person ” and “ treating him as such agent ”. It may be reasonable that *A* should not be required to render a return of *B*'s income until it has first been decided that he is agent of *B*: on the other hand, having regard to the circumstances which for this purpose constitute agency, it may well be thought advisable that the information afforded by a return and by books of account produced in support thereof should be available for the purpose of deciding as to agency. The avoidance of delay may also be a consideration. The matter must be determined entirely upon the language of the Act, and their Lordships cannot find that it imposes the technical requirements upon which the High Court have insisted. It seems to their Lordships to be open

to the Income tax Officer under the Act to postpone any final determination of the question of agency until the time comes to make an assessment under Sec. 23 of the Act".

Though under this decision an order declaring that the assessee is agent of the non-resident is not a condition precedent to the validity of a notice under Sec. 22 (2) calling for a return, in view of the opening observation of their Lordships that 'It may be reasonable that A should not be required to render a return of B's income until it has first been decided that he is an agent of B' it is obviously desirable that as a general rule proceedings should not be taken against residents for the assessment of income of non-residents until they are found to be agents of the non-residents.

Issue of Bonds for Interest : Whether Amounts to Receipt of Interest.

An interesting question relating to receipt of interest was decided in the King's Bench Division in England in *Cross (Inspector of Taxes) v. London and Provincial Trust Ltd.*, (106 L.J.K.B. 877). The assessee, a company, held certain bearer bonds issued by the United States of Brazil. The Government of Brazil suspended payment of interest on those bonds, and instead issued 'funding bonds' and the assessee received such bonds in exchange for his interest coupons. The bonds were of marketable value, and the company afterwards sold these bonds and realised their value, and the question arose whether the receipt of the funding bonds amounted to receipt of income. FINLAY, J., without questioning the general principle that, if by way of profit, instead of receiving money, money's worth is received, that money's worth is to be regarded as money and can be brought in for purposes of assessment, quoted in extenso the classical observations of LORD MACMILLAN in the Judgment of the Judicial Committee in *Maharaja of Darbhanga's Case* (1938 I.T.R. 94) and said :

"There is no doubt at all in the present case that these bonds were things of value, as is shown by the fact that they were things which could be sold and in fact were sold in the market. The question does not seem to be on the case before me, whether the bonds were things of value. The question is whether there was anything analogous to interest. A person receiving the bonds in these circumstances is not, I think, receiving interest, or indeed receiving income. The whole point seems to me to be that Brazil, unfortunately, was unable to pay interest, and so evolved its scheme of issuing these bonds; and, from the point of view of the recipient, the result of the transaction was that he received, instead of interest, a capital asset. That capital asset, if the obligations under it were duly fulfilled, would itself produce income and would result in income, which, if and when it were received, would

be liable to tax. I do not think that it can be said (and in this I agree with the Commissioners) that here there is a receipt of interest or a receipt of any income under Case IV. The whole point is that there was not income and that the capital asset was, so to speak, substituted for the income. I cannot regard this as being a payment of an equivalent of interest, a payment of interest in kind, so as to fall within the decision in *Scottish and Candian General Investment Co. v. Elasson* (8 Tax Cas. 265)".

Sale of Interest Coupons : Liability to Pay Tax.

In *Paget v. Inland Revenue Commissioners* [106 L.J.K.B. 881] FINLAY, J., has made some observations with regard to the liability to pay income tax in respect of the sale-proceeds of interest coupons and laid stress on the difference between the purchase price of interest coupons which are sold, and income from interest. The judgment contains the following lucid statement of the law on the subject :

"The matter is one of some difficulty, and various cases may no doubt be put. There is the simple case where a coupon is presented and interest received by the holder, and no one doubts there that there is interest, and that it is taxable. Equally so, if a banker or other agent presents the coupon on behalf of the holder. But if coupons are sold, and interest is then received by the purchaser, I think there that it is a sale and purchase, and a receipt of interest by the purchaser. The tax, it seems to me, has there to be borne by the purchaser by deduction, or by direct assessment, and the fact that the purchaser will have to bear tax will be reflected in the purchase price. He will consider, in deciding what he will pay for the coupon, that he has to bear tax on the interest when he receives it; but the tax is, of course, paid once and once only. It is paid, in the case I am putting, by the purchaser of the bond, and the fact that he will pay less for the coupon because he has to pay tax on the interest when he receives it does not cause the vendor of the coupon to bear tax. Another case may be put—an imaginary case: suppose that, three months before the due date, coupons for two sets of bonds, *A* and *B*, are sold, that the interest on *A* is paid three months later, and that the interest on *B* is not paid. It seems to me clear that in such a case the vendor receives the purchase price only. In the one case taxation arises because, and only because, interest is received, and the taxation is borne by the purchaser. In the other case, the case where in fact the interest is not paid and there is a repudiation of liability—a failure to pay—then there is no taxation because there is no interest received. The substance of the matter seems to me to be that if there is interest, wherever it is found, it is taxed. But if it is the purchase price of a coupon and not interest, then it is not liable to taxation. The interest will, of course, be liable to taxation if and when it is paid".

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PART III.

NOTES & COMMENTS.

Conversion of Joint Hindu Family Business Into Firm.

There have been two pronouncements recently on the conversion of Hindu joint family into firm, one of the Rangoon High Court, *Bansidhar & Sons v. Commissioner of Income-tax, Burma* (reported below at p. 95) and the other, of the Allahabad High Court, *S. C. Mullick and Sons, In re* (reported at p. 99 infra). In the former case the Rangoon High Court has held that before persons who have been previously assessed as a Hindu undivided family can claim to be separately assessed as members of a contractual partnership they must establish that the joint family has been dissolved, and that if the members of a family admit that for all purposes other than the business in question which they want to be registered as a firm they continue to be a joint family the fact that there was no ancestral property and that the business had been originally built up by the father with his own self-acquired property becomes immaterial and would not entitle the applicants to be registered as a firm in respect of that business.

The High Court further thinks that where an application is made by the members of a family to register themselves as a firm the application is governed by Sec. 25-A and not by Sec. 26-A. Upon this point we prefer the clear rulings of the Lahore High Court in *Mittarchand Lakhmidas'* and *Ram Rakha Mal and Sons'* cases that Sec. 25-A is confined to cases of disruption pure and simple unattended by conversion or transformation into a firm or company, and that if there is further formation of a firm amongst the members to continue the business the case falls within Sec. 26-A.

S. C. Mullick's Case the Allahabad High Court has more carefully stated the true principle in these words: "Persons cannot at one and the same time be members of a joint Hindu family in respect of a joint family property and be also members of a firm of which such property forms the assets". As Hindu law recognises partial partition, both as regards the property to be divided and in respect of the coparceners, it seems to be doubtful whether it can be laid down broadly that until there is a complete partition among the members there cannot be a firm. We think so long as Hindu law recognises partial partition it is open to the members of a family to effect a partition as regards a portion of the family property, e.g., the family business, and remain joint with regard to the remaining property. In such cases there is no reason why they cannot form themselves into a firm with regard to the business. The essence of the matter is, as the Allahabad High Court has said, they cannot claim to be treated as members of a firm in respect of a property so long as that property still remains their joint family property.

The statement contained in the judgment of the Rangoon High Court Case that once they admit they are joint with regard to all property other than the business in question they cannot be registered as a firm is we think too wide and requires re-consideration in the light of the recognised rules of Hindu Law relating to partial partition. The Privy Council have definitely and clearly held in *Ramalinga v. Narayana* [I.L.R. 45 Mad. 489] that "it is open to the members of a joint family to make a division and severance of interest in respect of a part of the joint estate, while retaining the rest as the properties of the joint undivided family."

In the Allahabad case the assessee failed because there was nothing to show that they had effected a division between themselves even in respect of the business in respect of which they sought to be registered as a firm.

We would bring to the notice of members of Hindu families who wish to register themselves as a firm in respect of their business the important point which emerges from the Allahabad High Court case, namely, that before they apply for registration they must first effect at least a partial partition among themselves in respect of the family business, and if there is clear evidence to show that such a partition has been effected, we do not think that the income tax authorities would be justified in refusing to register them as a firm in respect of that business.

DEPRECIATION OF MACHINERY.

(THE MAZAGAON DOCK CO.'S CASE : 1938 I.T.R. 124).

The question whether, when a business is acquired by one person from another, depreciation allowance is to be calculated on the original cost thereof to the vendor or on the cost thereof to the purchaser who is being assessed was one of the most vexed questions of Indian income tax law. There were several Full Bench decisions in which the question was considered from all points of view by the Indian High Courts. In the *Buckingham & Carnatic Co.'s Case* (1935 I.T.R. 384) the Judicial Committee in a judgment delivered by Sir Lancelot Sanderson, without referring to any of the difficulties pointed out by the learned Chief Justices of the Indian High Courts, said that the allowance is to be calculated in such cases on the original cost to the *purchaser*.

The recent decision of the Bombay High Court in the case of the *Mazagaon Dock Co. Ltd.*, (reported below at p. 124) shows that the difficulty has not yet been properly diagnosed and treated. Conflict of opinion is arising again over new aspects of the question, and even over the import of the Privy Council judgment itself.

Coming to the matter in hand, the short question that had to be decided in the *Mazagaon Dock Co.'s Case* was whether when the purchaser of a business is being assessed under Sec. 26 (2) of the Indian Income Tax Act in respect of the income earned by his vendor in the previous year, depreciation is to be calculated on the original cost of the buildings, machinery etc., to the purchaser, or on the original cost to the vendor.

The assessee who were purchasers contended that depreciation allowance should be calculated on the cost to their vendor whose income was being assessed and who was the owner of the buildings etc., in the year in which the profits were earned, and that they were also entitled to have the unabsorbed portion of the allowance deducted from their income. The income tax authorities held that in the *Buckingham and Carnatic Co.'s Case*, the Privy Council had said that the word 'assessee' in Sec. 10 (2) (vi) refers to the person who is being assessed, i.e., the purchaser, and that accordingly depreciation allowance could be granted only on the cost thereof to the purchaser.

On the question being referred to the High Court SIR JOHN BEAUMONT, C.J., and RANGNEKAR, J., held that the view of the income tax authorities was wrong but BLACKWELL, J., dissented. After considering all the relevant sections of the Act the majority held

that the Privy Council judgment does not cover a case of this kind where the purchaser is being assessed as successor under Sec. 26 (2). When the assessment is under Sec. 26 (2) the word 'assessee' in Sec. 10 (2) (vi) must be read as referring to the original owner whose profits are being assessed. We have no doubt that the decision of the majority is right and is in consonance with justice, though, of course, it is anomalous to construe the same word 'assessee' occurring in Sec. 10 (2) (vi) as referring to the 'vendor' in a certain set of circumstances and to the 'purchaser' in a different set of circumstances. As to this we have already expressed our view on several previous occasions that the principle of basing the calculation of depreciation allowance under Sec. 10 (2) (vi) on the cost paid by the purchaser for the time being is itself quite anomalous and so long as the clause is not amended the results will also be anomalous.

NECESSITY OF LEGISLATIVE INTERVENTION.

It is a matter for regret that the Income Tax Enquiry Committee's attention was not pointedly drawn to this vexed question. Though they have recommended that the basis of 'written down value' should be adopted instead of the 'original value to the assessee' they have not suggested any provision to remove the difficulties which present themselves when a business is transferred.

They suggest a definition of 'written down value' on the following lines : " 'Written down value' means : (a) in the case of assets acquired in the 'previous year', the actual cost to the assessee, and (b) in the case of assets acquired before the previous year but after the coming into operation of the amended section, the actual cost to the assessee less all depreciation allowed to him under the section."

The same questions, we believe, will arise again when there is succession to a business, to the utter annoyance of the business-world ; and we hope that the Central Board of Revenue when drafting the new bill will pay some attention to this aspect of the question and in particular to the conflicting views expounded in the *Mazagaon Dock Co.'s Case*. As pointed out in some of the judgments on the subject, clause (vi) as it now stands does not contemplate cases of succession at all, and a new sub-clause defining the procedure to be adopted in calculating depreciation allowance in the case of transfer of business is quite necessary.

Re-distribution of Companies Districts in Calcutta.

In exercise of the powers conferred by sub-section 4 of Sec. 5 of the Income Tax Act (XI of 1922) the following redistribution of the charges of the Income Tax Officers of the present Companies Districts in Calcutta has been sanctioned with effect from the 1st April 1937 (1938 ?) [Vide *Gazette of India* (Jan. 29, 1938), Part II, p. 197].

1. A new district to be known as Companies District III will be formed with the following classes of persons and income in the respective areas noted against each.

(A) *Classes of persons and area.* (i) All companies, excepting insurance companies and shipping companies as defined in sub-Sec. 6 of Sec. 2 of the Income Tax Act, 1922, and (ii) excepting Chinese firms and firms of Solicitors all firms which keep their accounts in English and which have been registered before the 18th January 1932 under Sec. 26-A of the above Act and their partners in the area of Calcutta Income Tax Districts I (1), I (2), II (1), II (2) IV (1), IV (2) and IV (3).

(B) All Insurance and Shipping Companies in the whole area of Calcutta as defined in Clause 11 of Sec. 3 of the Calcutta Municipal Act 1923, Fort William, the Esplanade and that part of Hastings North of the South Edge of Clyde Road and Strand to the river Bank.

(C) Non-residents whose income arises in Bengal and who are assessed direct and not through statutory agents under Sec. 43 of the Act.

(D) All Tramp Steamers who earn income in the Port of Calcutta.

Classes of income—All classes.

2. *Charge.* Companies District I—Classes of persons. (i) Excepting Insurance and Shipping Companies all Companies as defined in sub-Sec. 6 of Sec. 2 of the Indian Income Tax Act, 1922, and (ii) excepting Chinese firms and firms of Solicitors, all firms, which keep their accounts in English and which have been registered before the 18th January 1932 under Sec. 26-A of the above Act: and their partners.

Classes of income—All classes.

Area. Area of Calcutta Income Tax Districts III (1), III (2) and VI.

3. *Charge.* Companies District II—Classes of persons. (1) Excepting Insurance and Shipping Companies all companies as

defined in sub-Sec. 6 of Sec. 2 of the Indian Income Tax Act and (b) excepting Chinese firms and firms of solicitors, all firms which keep their accounts in English and which have been registered before the 18th January 1932 under Sec. 26-A of the above Act, and their partners.

Classes of Income—All classes.

Area. Area of Calcutta Income Tax District V.

Amendment to Auditor's Certificates Rules.

In exercise of the powers conferred by sub-section (2) of Sec. 144 of the Indian Companies Act, 1913 (VII of 1913), the Central Government has directed that the following further amendments shall be made in the Auditor's Certificates Rules 1932, the same having been previously published as required by the said sub-section, namely :—

1. In rule 22 of the said Rules—

(1) In clause (b), the words “ or an institution recognised by the Accountancy Diploma Board, Bombay, under the regulations for the award of the Government Diploma in Accountancy ” shall be omitted.

(2) For clause (c) the following clause shall be substituted namely :—

“(c) produces a certificate that he has served for not less than seven years either wholly as an audit clerk in the office of an Approved Accountant or partly (but for not less than four years) as such clerk and partly as an articled clerk. In the latter case, one year's service as an articled clerk may be reckoned as two years' service as an audit clerk in the office of an Approved Accountant, or ”

(3) After clause (c) the following clause shall be inserted, namely :

“(d) produces evidence to show that he was at any time admitted to the examination for the Government Diploma in Accountancy held by the Accountancy Diploma Board, Bombay, or was eligible for admission to that examination ”.

2. In appendix 2 to the said Rules, in sub-clause (c) of clause 4 in Form D, and in sub-clause (c) of clause 5 in Form E, after the words “ or cease to be borne on the list of Approved accountants maintained under the Auditor's Certificates Rules, 1932,” the following words shall be inserted namely :—

“ or shall in any way become incapable of continuing the intended employment of the Articled Clerk ”.

[See *Gazette of India* (Jan. 29, 1938), Part I, p. 120].

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PART IV.

NOTES & COMMENTS.

Reference: Costs of Getting Reference Drawn up by Solicitor and Settled By Counsel.

A question of practice relating to taxation of costs in a reference under Sec. 66 of the Indian Income Tax Act was decided by the Bombay High Court in *Sir Chinnubhai Madhowlal's Case* (reported below at p. 148). The learned judges who heard a reference ordered 'costs to be paid by the assessee on the original side scale', and the Taxing Officer allowed the costs incurred by the Commissioner in having the reference drawn up by the Government Solicitor and settled by the Government Advocate. The assessee applied to the Court for excluding this item from the taxed amount of costs. The Chief Justice, SIR JOHN BEAUMONT, states his opinion on the point in these words:

"It seems to me that it is the application of the assessee to the Commissioner to state a case and make a reference to the High Court which starts the proceedings which ultimately result in the reference, and in my opinion, the Court can deal with all the costs of, and subsequent to, the application. In a proper case, the Taxing Master is entitled to allow to the assessee, if he has been given his costs, the costs of obtaining proper advice in settling the application; and where the costs are given, as in this case, to the Commissioner, in my opinion, the Taxing Master is entitled to allow the Commissioner the costs of getting the reference settled by the Government Solicitor and the Advocate-General. It is entirely in the discretion of the Taxing Master to decide whether the case is of sufficient difficulty to justify the Commissioner in adopting the course. If the Taxing Master thinks that it is a simple case, he probably will not allow the fees for settling it."

Desirability of Getting References Drawn up and Settled By Lawyers.

Continuing, the Chief Justice made the following further observation to which we would invite the careful attention of the Income Tax Commissioners of India:

"Most of these cases are not very simple, and *it is of importance that they should be settled with accuracy by somebody acquainted with the art of draftsmanship*". (Italics are ours).

It is obvious that questions have to be very carefully framed and we have no doubt that, as observed by the Taxing Master of Bombay, confused references would result in considerable waste of judicial time and even a reference back to the Commissioner. Commissioners would certainly be well advised in having references revised and finally settled by their legal advisers in all important cases. A glance at the way in which some cases are stated and questions are framed in the Income Tax References would convince anyone of the importance and truth of the observations made by the learned Chief Justice of Bombay.

LOSS BY THEFT.

MULCHAND HIRALAL'S CASE (1938 I.T.R. 151).

The interesting question whether loss by theft is an allowable deduction in computing the profits derived from business was recently considered by the Patna High Court in *Mulchand Hiralal's Case* (reported at p. 151 below) and their Lordships (SIR COURTNEY TERREL, C. J., and AGARWALLA, J.) have taken a much stricter view than has hitherto prevailed. The same High Court had held in *Jagannath Therani's Case* (I.L.R. 4 Pat. 385) that embezzlement by servants is a permissible deduction. The learned judges seem to think that that decision is wrong and should be reconsidered. *Mulchands' Case* was one of theft from the hands of an employee by a stranger and falls within the class of theft by outsiders and not embezzlement by servants and it was held that the loss could not be deducted. Their Lordships have gone further and say that embezzlement by servants also stands on the same footing. Whatever the exact answer may be, it is clear that their Lordships are under a misapprehension as to the legal basis on which a claim for deduction on account of theft or embezzlement is made. They think that such claim is made, and could be allowed, only as an expenditure incurred to earn profits as provided for in Sec. 10 (2) (ix) of the Indian Income Tax Act. Obviously, loss by theft or embezzlement is not expenditure incurred to earn profits. Hence their Lordships conclude that the loss is not allowable.

THE TRUE PRINCIPLE.

Section 10 (2) (ix) however, has nothing to do with such claims at all. Claims for loss by theft or embezzlement are, like bad debts, allowed on an entirely different principle based on the meaning of 'profits'. In the leading case of *Sir S. M. Chitnavis* (28 N.L.R. 205) the Judicial Committee have stated the principle in these words:

"Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to income tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains."

It is clear from this statement that the reasoning of the Patna High Court that Sec. 10 (2) (ix) does not contemplate loss by theft or embezzlement and that this concludes the matter against the assessee is not correct. What we have to determine is whether the loss in question is a trading or business loss and if it is, the loss must be deducted. The question is whether a businessman in calculating the income or profits of his business would include sums embezzled by his employees, or stolen from his business premises. From this aspect we think the earlier decision of the Patna High Court in *Jagannath Therani's Case* that loss by embezzlement by servants should be deducted is right and *Mulchand's Case* so far as it dissents from *Jagannath Therani's Case* requires reconsideration. Even with regard to theft by outsiders SIR C. V. ANANTAKRISHNA AYYAR's dissenting opinion in *Ramaswami Chettiyyar's Case* has much to be said in its favour, but as this raises more complicated questions we are not entering on this subject now.

Depreciation of Machinery.

In commenting on the *Mazagaon Dock Case* in our last issue we had emphasised the necessity of amending the provisions of the Indian Income Tax Act relating to depreciation of machinery. We find that Mr. Justice BLACKWELL also has in his judgment delivered in the case, adverted to this point. His Lordship has said:

"It may be that it would be just to amend the Act to meet a case like the present, but that is a matter for the Legislature, and upon the plea that justice requires it I do not feel myself at liberty to place upon Sec. 10 (2) (vi) a strained and artificial meaning..."

It is obvious that in his Lordship's view also the wording of the section as it stands does not enable the court to do justice to the assessee, and that an amendment of the Act to provide for cases of succession to business is an urgent necessity.

A New Question Relating to Bad Debts.

The recent judgment of the Calcutta High Court in *Bissen-doyal Doyaram's Case* (to be reported), though rather short, raises

a question of very great importance to businessmen in general. The right to deduct bad debts in the calculation of the profits of a business is already in a somewhat muddled state and the present decision reveals further difficulties.

When there is a succession to a business the successor is entitled to claim a deduction for bad debts in the same manner as his predecessor. *Bissendoyal Doyaram's Case* deals with the situation which arises when in a partition between the members of a family debts due to the family business are also divided between the several members but the business with the old trade name and goodwill is continued by one of them. The Calcutta High Court has held in this case that the other members to whom debts are allotted are not entitled to claim a deduction if the debts which they received on partition turn out to be bad. The argument which has prevailed is that, so far as the members other than the member who continues and succeeds to the family business is concerned the debts become a capital asset and if they turn out to be irrecoverable there is only a capital loss.

In the case in question a father and his son, members of a joint family, carried on a business. In a partition the son was given a part of his share in the coparcenery assets and a debt due to the family of a nominal value of Rs. 1,13,535 but valued for the purposes of partition at Rs. 22,052. The father continued to carry on the old business with his trade name and goodwill and the son was allowed to carry on a separate business of the same nature. The debt became irrecoverable and the son claimed that the whole amount of Rs. 1,13,535 or at any rate the value of the debt as stated in the partition deed, namely, Rs. 22,052 should be deducted as a bad debt in computing the profits earned by him in the year of assessment. The High Court held that the son was not a successor to the old business. What he actually got was a share in the assets of the old business and that asset became capital in his hands. Therefore it must be taken that this debt which was due from the debtor to the old business came into the hands of the son not as a debt due to him in respect of the business which he was carrying on or was about to carry on, not as a debt of the old business but simply as an asset which could be used as capital in his hands if he so chose to use it, assuming he could recover it.

As bad debts are very often allotted to coparceners in partition the results of this decision will be far-reaching. The matter requires very careful consideration,

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PART V.

NOTES AND COMMENTS.

THE NEW YEAR'S BUDGET AND INCOME TAX.

DISTRIBUTION TO PROVINCES

The budget for the current financial year contains some interesting matters relating to income tax. The improvement in the railway revenues has made it possible to begin the distribution of income tax receipts to the Provinces under the Niemeyer award. The amount to be distributed has been arrived at thus. The net surplus of the railways for the year is now expected to be Rs. 2,83 lakhs. The total amount of the taxes on income other than corporation tax, after deducting (i) taxes collected in central area (ii) taxes on salaries paid from central revenue and (iii) costs of collection, is Rs. 1,155 lakhs. The combined total of the railway surplus and the sum of Rs. 1,155 lakhs less 13 crores, *viz.*, Rs. 138 lakhs is the amount distributable to the Provinces.

REVISED ESTIMATE.

The total revised estimate of taxes on income including corporation tax and other elements which are wholly central is Rs. 15 crores as compared with the budget estimate of Rs. 1,430 lakhs, an improvement of Rs. 70 lakhs. This is taken as an indication that the progress of recovery in the country as a whole was not seriously interrupted during the previous year in spite of the temporary decline in imports which was reflected in the receipts from customs duties. Out of this amount of 15 crores, 138 lakhs will be distributed to the Provinces as mentioned above and there will be Rs. 1,362 lakhs for the Central Government.

NEXT YEAR'S BUDGET.

The Finance Member hopes to introduce shortly the Income Tax (Amendment) Bill. The first effect of this Bill would be a considerable increase in the revenue but this increase cannot accrue before 1939-40 and even so for this year and the two succeeding years the whole benefit will practically go to the Provinces. After that one half of the benefit will revert to the centre. For the

ensuing year the Finance Member has budgetted for an improvement of Rs. 25 lakhs in view of trade activities during the major part of the current year and in view of the efforts which are being made by the Government to tighten up the administration. The greater part of this increase also will benefit the Provinces and not the Central Government unless railway revenues fall below expectations. If the estimates for taxes on income are realised the amount of income tax available for distribution to the Provinces next year would be Rs. 128 lakhs.

EXPENDITURE INCURRED TO EARN AGRICULTURAL INCOME OF MONEY LENDING BUSINESS.

CHELLAPPA CHETTIAR'S CASE (1937 I.T.R. 97).

Persons carrying on money-lending business are often compelled to take over agricultural lands of their debtors in satisfaction of otherwise unrealisable debts and to receive as part of their profits the rents realised from tenants in respect thereof. Our readers may remember that in *Chellappa Chettiar's Case* (1937 I.T.R. 97) the question arose whether an assessee who becomes the owner of agricultural lands in such circumstances is entitled to a deduction of the interest paid by him on so much of the capital which he had borrowed for business purposes as is represented by the agricultural lands got in under Sec. 10 (2) (iii) and whether he is entitled to a deduction in respect of the establishment and other charges incurred by him for managing and cultivating such lands under Sec. 10 (2) (ix). A Full Bench of the Madras High Court decided in that case that he was entitled to deduct these items from the profits of his money-lending business even though the income arising from the agricultural lands, being agricultural income, could not be included in the assessable profits.

We had expressed some doubts about the correctness of this decision (see 1937 I.T.R. Notes and Comments pages 12 to 14). The decision appeared to us "to cut at the root of the distinction between income from business and agricultural income which the Judicial Committee had emphasised in the *Maharajah of Darbhanga's Case*".

RANGOON HIGH COURT DISAGREES : N.S.A.R. CASE (1938 I.T.R. 194)

In a very learned judgment a Full Bench of the Rangoon High Court has recently considered the question very carefully and come to the conclusion that in such cases the owner of the money-lending business is not entitled to a deduction of the

expenditure incurred by him for earning the agricultural income. Their Lordships are of the opinion that agricultural income is altogether excluded from the scope of the Act, as laid down by the Privy Council in the *Maharaja of Darbhanga's Case* (14 Pat. 628); 'business' as defined in Sec. 6 (iv) does not include the business of leasing agricultural lands and receiving the rents; the expression "profits or gains of any business" as used in Sec. 10 (1) does not include agricultural income; and consequently the expression "such profits or gains" in clause (ix) of Sec. 10 (2) does not include agricultural income. Therefore, when the business of an assessee comprises both agricultural income as defined in the Act and other taxable income the assessee is not entitled under Sec. 10 (2) (ix) to deduct from such other income the expenditure incurred for the purpose of earning the agricultural income. Their Lordships have refused to follow the decision of the Madras High Court in *Chellappa Chettiar's Case* in so far as that decision holds to the contrary.

With regard to the case of *Hughes v. Bank of New Zealand* which was relied on by the Madras High Court in support of their conclusion the learned Judges of the Rangoon High Court say that that decision is not applicable to cases arising under our Income Tax Act, as the wording of the English and Indian Acts are different in this connection.

It may however be noted that the decision of the Rangoon High Court is to some extent based on the wording of Sec. 10 (2) (ix) and that the learned Judges have not expressly dissented from *Chellappa Chettiar's Case* in so far as it relates to claims for deduction of interest on borrowed capital under Sec. 10 (2) (iii).

POWER TO ASSESS NON-RESIDENT WITHOUT APPOINTING AN AGENT.

The recent decision of the Allahabad High Court in the case of the *Maharaja of Benares* (to be reported in the next issue) changes the whole trend of the decisions on an important point relating to non-residents.

Section 42 (1) of the Indian Income Tax Act provides that all profits or gains accruing or arising to a non-resident, whether directly or indirectly, through or from any business connection or property in British India shall be deemed to be income accruing or arising within British India and shall be chargeable to income tax *in the name of the agent of any such person and such agent shall be deemed to be, for all the purposes of this Act,*

the assessee in respect of such income tax. There is also a proviso to this section which prescribes that any arrears of tax may be recovered also from any assets of the non-resident which are, or may at any time come, within British India. The wording of the section gives rise to the question whether a non-resident can be assessed only through his agent, in other words, whether it precludes the income-tax authorities from assessing a non-resident by serving a notice on him direct without appointing an agent.

THE EARLIER VIEW.

This question arose for decision in 1921 before the Madras High Court in *Bhanjee Ramjee & Co's Case* (44 Mad. 773) and that Court held that a non-resident can be served with a notice and can be assessed without an agent being appointed. The High Court was of the opinion that the section of the Act of 1918, corresponding to Section 42 (1), merely provided machinery by which the tax can be levied where the non-resident cannot himself be got at.

The decision in *Bhanjee Ramjee & Co's Case* was accepted as correct by the Bombay High Court in 1933 in the case of *Commissioner of Income Tax, Bombay Presidency and Aden v. National Mutual Life Association of Australasia* (57 Bom. 519; 1933 I.T.R. 350). In this case RANGNEKAR, J., said: "The point arose in *Chief Commissioner of Income Tax, Madras v. Bhanjee Ramjee & Co.*, [44 Mad. 773] and it was held that a principal was liable to assessment under Sec. 42 without an agent being appointed under Sec. 43. In my opinion this view is correct." BEAUMONT, C. J., also was of the same opinion.

ALLAHABAD HIGH COURT DISSENTS.

In the case of the *Maharaja of Benares* decided on the 24th January 1938, the Allahabad High Court, after referring to the two English cases upon which the decision in *Bhanjee Ramjee & Co's Case* was based, observe that there are material differences between the statute of England on which the English cases were based and the Indian Income Tax Act. Their Lordships say that they are clearly of opinion that the question must be decided by reference to the provisions of the Indian Act alone, and state their opinion on the question in these words:—

"The only construction which we can place on the language of Sec. 42 (1) is that the agent alone and not his non-resident principal shall for the purposes of this Act be treated as the

assessee, *i.e.*, as the person to whom a notice under Sec. 22 (2) shall issue and by whom the tax is payable. The word "shall" in Sec. 42 (1) is significant; it shows that the provisions of that section are mandatory and in our opinion the department is precluded from issuing notices to the principal and from treating the principal as the assessee except to the limited extent that any arrears of tax may also be recovered from assets of his which may be found in British India."

With regard to the proviso to Sec. 42 (1), their Lordships are of the opinion that it does not militate against the view that they have taken and does not support the view that it is open to the Income Tax Officer to address notices direct to a non-resident. The proviso only contemplates the possibility of the agent not being able to pay the income tax. It does not overrule the mandatory provision contained in the main section that the income shall be chargeable in the name of the agent and that the agent shall be deemed to be the assessee in such cases.

There is thus a direct conflict between the earlier view propounded in the decisions of the Madras and Bombay High Courts on the one hand, and the view now taken by the Allahabad High Court on this important point and we shall await with great interest the future development of the law on this question.

Costs of Obtaining Probate of Will Whether Deductible from Chargeable Income : Judicial Committee affirm *P. C. Mallick's Case*.

The judgment of the Calcutta High Court in the case of *P. C. Mallick and D. C. Aich, In re*, (1936 I.T.R. 369) has been recently affirmed by the Judicial Committee. It will be remembered that the question in that case was whether the executors of a deceased person who have paid certain sums of money for the performance of the *sradh* of the deceased and to defray the costs of obtaining probate of his will are entitled to have these sums excluded from the assessable income in their hands. The High Court held that these were not cases of allocation of revenue before it became income in the executors' hands, but application of income by the executors in a particular way and that the expenses could not therefore be deducted. The Judicial Committee, affirming this decision, said :

"The payment of the *sradh* expenses, and the costs of probate were payments made out of the income of the estate coming to the hands of the appellants as executors, and in pursuance of an obligation imposed by their testator. It is not a case (like the

case of *Raja Bejoy Singh Dudhuria v. Commissioner of Income Tax, Calcutta*, in which a portion of income was by an overriding title diverted from the person who would otherwise have received it. It is simply a case in which the executors having received the whole income of the estate apply a portion in a particular way in pursuance of the directions of their testator, in whose shoes they stand."

Priority of Income Tax Debts and Power of Court to Order Payment.

The question whether, when the property of an assessee is attached in execution of a decree by his creditors, or funds of an assessee are lying in Court, the income tax authorities are entitled to apply to the Court for an order for payment of arrears of income tax due by the judgment debtor out of the proceeds in preference to the claims of the creditors, was recently referred to a Full Bench of the Madras High Court in *Manickam Chettiar v. Income Tax Officer, Madura* (reported below at p. 180 ff). The Rangoon High Court had in *Soneram Rameshur v. Mary Pinto* [1934 I.T.R. 58] upheld both the Crown's right to priority in respect of income tax debts and the power of the Court to order payment of such debts out of funds in its custody on a mere application by the income tax authorities. There was not much difficulty about the Crown's right of priority but it was strongly urged before the Madras High Court that the proper remedy of the department was not to make an application but to obtain a decree first or to proceed under Sec. 46 of the Income Tax Act. The Full Bench has held that Sec. 46 of the Act is not exhaustive of the remedies of the Crown and that the Court has ample power to make an order for payment on a mere application made to it. It is not necessary for the Crown to obtain a decree or even to effect an attachment before making such an application. We may also refer in this connection to the case of *Secretary of State for India v. Ma Nyein Me and others* [1937 I.T.R. 560] in which the case of *Soneram Rameshur* was referred to with approval and the right of the income tax department was upheld in similar circumstances. This case, though it does not appear to have been brought to the notice of the Madras High Court, fully supports the view of the Full Bench in *Manickam Chettiar's Case*.

Insurance Companies : Power of Income Tax Department to Go Behind Actuarial Balance Sheet.

In the case of the *Himalaya Assurance Co., In re* (to be reported in the next issue) the Calcutta High Court has answered in

the negative the following question : " The assessee's actuarial valuation balance sheet on the last date of the last preceding valuation having shown a deficiency, does the provision of Rule 25 of the rules under the Income Tax Act for ascertaining the average annual net profits of a life assurance company permit the department to go behind the said valuation balance sheet to find out if there were any profits in respect of the period of the last preceding valuation."

In their Lordships' view the matter is concluded by the judgment of the Privy Council in the case of the *Bharat Insurance Co., Ltd.* (1934 I.T.R. 63). The 'net profits' in Rule 25 clearly mean the 'surplus, if any' as shown in the statutory form of the valuation balance sheet of 'life assurance and annuity funds (as per balance sheet under the Third Schedule)' over the 'net liability under life assurance annuity transactions (as per summary statement provided in Fourth Schedule)', and the income-tax authorities have no power to go behind the valuation balance sheet to find out whether there were any profits.

Definition of 'Income'.

The judgment of the Allahabad High Court in the *Ausanganj Estate Case, Kedar Narain Singh v. Commissioner of Income Tax, U. P.* (reported at p. 157 below) contains some instructive observations on the true import of the word 'income' which require notice. Their Lordships say :

" Now an attempt to define the word 'income' has baffled the Legislature and the Judges. The Act itself does not define it, and in Section 6 the best that has been done in this respect is to say what heads of income, profits and gains shall be chargeable to income-tax and under these heads we find the following sub-heads: (i) Salaries, (ii) Interest on Securities, (iii) Property, (iv) Business, (v) Professional earnings and (vi) Other Sources. Although in the succeeding provisions an attempt has been made to describe the first five sub-heads, Section 12 deals with the omnibus sub-heading of 'Other Sources' and all that could be said there was that 'Other Sources' included 'income', profits and gains of every kind and from every source to which this Act applies". It is therefore clear that the word 'income' is a word of elastic ambit, and Courts when considering whether any particular sum can be said to be the income of an assessee have attempted either to bring it in or to exclude it from a certain description which they have chosen to the word income, but they have always qualified the said

description by saying that it is not exhaustive". Continuing, their Lordships say that as observed by the Privy Council in *Maharaj Kumar Gopal Saran Narain Singh's Case* "anything which can properly be described as income is taxable under the Act unless expressly exempted" and that this is perhaps the best definition of income although it may be said to be tautologous.

Allowances Paid to Relations of Wards.

Kedar Narain Singh's Case mentioned above shows that where the Court of Wards or persons in a similar position make allowances to relations of the ward, who are not strictly members of the joint family to which the ward belongs, the question may arise whether the sums received by such relations are their 'income' assessable again in their hands or only mere expenses incurred by the Court of Wards from its income on behalf of these relations. It has been held in this case that where a fixed allowance is made and its expenditure is entirely under the control of the recipient and the latter is not accountable for it, it would be 'income' in his hands. It is not difficult to escape this kind of double taxation if the records are so maintained as to make such expenses retain the nature of expenses incurred by the Court of Wards.

English and Indian Law of Income Tax.

In the case of *N.A.S.R. Concern*, Mr. Justice Dunkely has referred to the fundamental differences between the English and Indian systems of Income Tax Law in these words:—

"In England a person is assessed to income tax in respect of his income, while under the Burma Act (same as the Indian Act) it is the income, which is taxed. Under the English Act no class of income is outside the scope of the Act, whereas by Section 4 (3) of the Burma Act, the Act is made applicable to a number of classes of income. The English Act merely confers certain exemptions on a person in respect of his income up to a certain amount or of certain kinds, similar to the exemptions conferred on certain classes of income by the provisos to Sections 8 and 9 of the Burma Act. Moreover the 'expenses deduction' clause (if it may be so called) of the English Act is in different and far wider terms than that of the Burma Act. . . . The distinction between the expression 'incurred solely for the purpose of earning such profits and gains' (used in the Indian Act) and the expression 'expended for the purposes of the trade, profession, employment or vocation' (used in the English Act) is so manifest as to need no comment".

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NOTES & COMMENTS.

ASSESSMENT OF LIFE INSURANCE COMPANIES :

Himalaya Assurance Co.'s Case (1938, I.T.R. 227).

In *Himalaya Assurance Co., In re* (reported below at p. 227) the Calcutta High Court has in a rather short judgment disposed of a question of considerable general importance relating to the assessment of life insurance companies.

The actuarial valuation balance sheet of the company in question for the quinquennium which ended on the 28th February 1935 showed a deficit of Rs. 1,13,490, and the company made a return for the assessment year 1936-37 showing a loss of Rs. 22,698, being one-fifth of the said deficit shown in the actuarial balance sheet. The Income Tax Officer refused to accept this return. As the balance sheet for the preceding quinquennium which ended on the 28th February 1930 showed a deficit of Rs. 2,08,228 and as this deficit had been carried forward in the valuation for the period ending 28th February 1935, he held that the balance sheet for the period ending on February 28, 1935, really disclosed a surplus of Rs. 2,08,228 *minus* Rs. 1,13,490 or Rs. 94,728, and levied income tax on one-fifth of this sum after adding back inadmissible deductions. The question was whether the income tax department had power to make an assessment in this manner under Rule 25 of the Income Tax Rules.

CONTENTIONS OF THE PARTIES.

It was contended on behalf of the company that though there might have been a surplus in an actuarial valuation period, Rule 25 under which the income is to be computed precludes the income tax authorities from considering that surplus independently and that an assessment can be made only when the actuarial valuation balance sheet shows a surplus on the face of it. The

Commissioner's contention is stated very lucidly in the following passage which appears in the statement of the case:—

"The result of the actuarial valuation of a life assurance company as disclosed in the actuarial accounts at the end of a given period is really a continuation of previous valuation, and adjustment must necessarily be made to find out what really is the surplus or deficit of a given period (in this case, a quinquennium) in order to determine the assessability or otherwise of the company in terms of Rule 25. If the result of the valuation of a period preceding the period which is made the basis of an assessment is a surplus, such portion of that surplus as has not been appropriated by way of bonus, etc., automatically comes to be merged in a subsequent valuation and unless such unappropriated surplus is taken out of the next valuation results, there will obviously be double taxation of some income. Similarly, if the result of the valuation of a period preceding the valuation which is made the basis of assessment of a given year is a deficit, such deficit will automatically find its way into the next valuation. To arrive at the annual average net profit, adjustment will therefore have to be made to avoid the results as above stated and such adjustment is accordingly permissible by Rule 25."

THE JUDGMENT.

The judgment as we have stated is a very short one. The learned Chief Justice, with whom the other Judges agreed, says that the matter is concluded by the Judgment of the Privy Council in the *Bharat Insurance Co.'s Case* [61 I.A. 41; 1934 I.T.R. 63]. His Lordship, after quoting two passages from that judgment, says "in my view that clearly states the legal position in this case and the answer to the question asked by the Commissioner of Income Tax must be in the negative".

The passages run as follows :

".....Under Rule 25 made under Section 59 of the Indian Income Tax Act, 1922, 'the income, profits and gains of a life assurance business shall be the average annual net profits disclosed by the last preceding valuation'; that is to say, shall be arrived at by taking one-fifth of the surplus disclosed in the valuation balance-sheet already mentioned and treating it as the average annual income of the business for the next quinquennium".

"The 'net profits' in this rule clearly mean the 'surplus if any' in the statutory form of valuation balance-sheet set out

above, of 'life assurance and annuity funds (as per balance-sheet under third schedule)' over the 'net liability under life assurance and annuity transactions (as per summary statement provided in fourth schedule)'".

THE REAL ISSUE.

We entirely fail to see how the question is concluded by the decision of the Privy Council in the *Bharat Insurance Co.'s Case*. That case had nothing to do with the present question or anything allied to it. The first passage quoted merely recites Rule 25 of the Income Tax Rules and does not throw any light on the present question and the general statement made in the next passage about net profits is certainly not intended to shut out questions like the present. The form in which the question was framed has perhaps diverted the Court's attention from the real issue to be decided. The expression 'go behind the said balance sheet' used in the question is unhappy. The income-tax authorities do not attempt to go behind the balance sheet in a case of this nature. They accept the balance sheet entirely and simply ask themselves what is the average annual net profit *disclosed* by it.

The real question turns upon the meaning to be given to the word '*disclosed*' in Rule 25. There is much to be said in favour of the Commissioner's argument that the word '*disclosed*' in Rule 25 does not preclude us from taking the surplus or deficiency into account when these are carried over to a subsequent valuation period. Whatever the correct view be, the real point to be decided has not been considered in the *Himalaya Assurance Co.'s Case*, and the *Bharat Insurance Co.'s Case* which the learned Judges say concludes the matter does not throw any light on the question in hand.

The view taken in *Himalaya Assurance Co.'s Case* may be beneficial to companies with deficit balance sheets but it would result in double taxation in the case of companies with a surplus balance as observed by the Commissioner. The matter requires careful consideration. The case is one which deserves to be taken up to the Judicial Committee and we hope the Judgment of the Judicial Committee would enlighten us on the points raised by the Commissioner.

Profit From Isolated Transaction of Sale of Property: Capital or Income.—B. B. Jubb's Case.

Where property is purchased and then re-sold and a surplus accrues to the seller the question arises whether this surplus is

income and assessable as such or a mere accretion to the capital. *B. B. Jubb's Case* (reported below at p. 210) shows the great difficulty of deciding such cases and defining the provinces of the Commissioner and the High Court. In *Jubb's Case* the Commissioner of Income Tax found that the assessee purchased a mine with the intention of re-selling it with advantage when opportunity arose, that the re-sale was also effected with a view to make a profit and not merely to convert the capital into cash for the purpose of a fresh investment and that the profits were therefore assessable. In such circumstances the only questions that could arise are whether there was evidence upon which the Commissioner could arrive at such a finding and whether he had misdirected himself on any principle of law applicable to such cases. The High Court would not interfere even if on the evidence it would have come to a different conclusion.

DIFFICULT QUESTION OF FACT.

Even on the question of fact itself it is extremely difficult to decide whether the transactions of purchase and re-sale constituted business or were merely isolated transactions resulting indirectly in an accretion to the capital. In this matter assesseees are entirely at the mercy of the income tax authorities, for in almost every case the idea of selling at a profit if opportunity arose would scarcely be absent in the minds of a purchaser when he acquires a property and also when he re-sells it.

LAW ON THE POINT.

Anyhow the decision in *Jubb's Case* contains the following statement of the law on the point which is worth remembering :—

“Mr. Foucar has been driven to contend that unless there was a primary intention at the time of his acquiring the Yemone Tin Mine to enter on an adventure in the course of trade it cannot be found that such an adventure was subsequently entered into unless there were a series of transactions. We think this view of the law is based upon a misconception, and that in the words of LORD BUCKMASTER in *The Rees Roturbo Development Syndicate, Ltd. v. Commissioners of Inland Revenue* (13 T.C. 366) the real question is whether there was a gain made in an operation of business in carrying out a scheme for profit making.”

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INCOME TAX AND THE NEW CONSTITUTION.

Now that the Government have begun to apply the provisions of the new Government of India Act to the Administration of income tax in India it is necessary to acquaint ourselves with the material provisions of the said Act relating to income tax.

TAXES ON INCOME GENERALLY.

Section 138 of the India Act provides that taxes on income other than agricultural income shall be levied and collected by the Federation, but a prescribed percentage of the net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Chief Commissioners' Provinces or taxes payable in respect of Federal emoluments, shall not form part of the revenues of the Federation, but shall be assigned to the Provinces and to the Federated States, if any, within which that tax is leviable in that year and shall be distributed among the Provinces and those States in such manner as may be prescribed.

The percentage originally prescribed under this provision shall not however be increased by any subsequent Order in Council: and the Federal Legislature may at any time increase the said taxes by a surcharge and the whole proceeds of such surcharge shall form part of the revenues of the Federation.

Notwithstanding anything in the preceding provision the Federation may retain out of the moneys assigned by that provision to Provinces and States—(a) in each year of a prescribed period such sum as may be prescribed; and (b) in each year of a further prescribed period a sum less than that retained in the preceding year by any amount, being the same amount in each year, so calculated that the sum to be retained in the last year of the period will be equal to the amount of each such annual reduction:

Provided that (i) neither of the periods originally prescribed shall be reduced by any subsequent Order in Council; (ii) the Governor-General in his discretion may in any year of the second

prescribed period direct that the sum to be retained by the Federation in that year shall be the sum retained in the preceding year, and that the second prescribed period shall be correspondingly extended, but he shall not give any such direction except after consultation with such representatives of Federal, Provincial and State interests as he may think desirable, nor shall he give any such direction unless he is satisfied that the maintenance of the financial stability of the Federal Government requires him so to do.

Where an Act of Federal Legislature imposes a surcharge for Federal purposes under this section, the Act will provide for the payment by each Federated State in which taxes on income are not leviable by the Federation of a contribution to the revenues of the Federation assessed on such basis as may be prescribed with a view to securing that the contribution shall be the equivalent, as near as may be, of the net proceeds which it is estimated would result from the surcharge if it were leviable in that State, and the State shall become liable to pay that contribution accordingly.

In the above provisions "taxes on income" does not include a corporation tax; "prescribed" means prescribed by His Majesty in Council; and "Federal emoluments" includes all emoluments and pensions payable out of the revenues of the Federation or of the Federal Railway Authority in respect of which income tax is chargeable.

CORPORATION TAX.

With regard to Corporation Tax Section 139 provides that corporation tax shall not be levied by the Federation in any Federated State until ten years have elapsed from the establishment of the Federation.

Secondly, that any Federal law providing for the levying of corporation tax shall contain provisions enabling the Ruler of any Federated State in which the tax would otherwise be leviable to elect that the tax shall not be levied in the State, but that in lieu thereof there shall be paid by the State to the revenues of the Federation a contribution as near as may be equivalent to the net proceeds which it is estimated would result from the tax if it were levied in the State.

Thirdly, that where the Ruler of a State so elects as aforesaid the officers of the Federation shall not call for any information or returns from any corporation in the State, but it shall be the duty of the Ruler thereof to cause to be supplied to the Auditor-General of India such information as the Auditor-General may

reasonably require to enable the amount of any such contribution to be determined.

If the Ruler of a State is dissatisfied with the determination as to the amount of the contribution payable by his State in any financial year, he may appeal to the Federal Court, and if he establishes to the satisfaction of that Court that the amount determined is excessive, the Court shall reduce the amount accordingly and no appeal shall lie from the decision of the Court on the appeal.

EXEMPTION OF CERTAIN PUBLIC PROPERTY FROM TAXATION.

Section 154 provides that property vested in His Majesty for purposes of the government of the Federation shall, save in so far as any Federal law may otherwise provide, be exempt from all taxes imposed by, or by any authority within, a Province or Federated State :

Provided that, until any Federal law otherwise provides, any property so vested which was immediately before the commencement of Part III of this Act liable, or treated as liable, to any such tax, shall, so long as that tax continues, continue to be liable, or to be treated as liable, thereto.

EXEMPTION OF PROVINCIAL GOVERNMENTS AND RULERS OF FEDERATED STATES IN RESPECT OF FEDERAL TAXATION.

Section 155 of the India Act provides that subject as therein-after provided, the Government of a Province and the Ruler of a Federated State shall not be liable to Federal taxation in respect of lands or buildings situate in British India or income accruing, arising or received in British India: Provided that (a) Where a trade or business of any kind is carried on by or on behalf of the Government of a Province in any part of British India outside that Province or by a Ruler in any part of British India, nothing in this sub-section shall exempt that Government or Ruler from any Federal taxation in respect of that trade or business, or any operations connected therewith, or any income arising in connection therewith, or any property occupied for the purposes thereof ; (b) nothing in this sub-section shall exempt a Ruler from any Federal taxation in respect of any lands, buildings or income being his personal property or personal income.

(2) Nothing in this Act affects any exemption from taxation enjoyed as of right at the passing of this Act by the Ruler of an Indian State in respect of any Indian Government securities issued before that date.

RELIEF IN RESPECT OF TAX ON INCOME TAXABLE BOTH IN
INDIA AND BURMA.

Section 159 provides that His Majesty in Council may make provision for the grant of relief from any Federal tax on income in respect of income taxed or taxable in Burma. An Order in Council has been issued under this section called The India and Burma (Income-tax Relief) Order, 1936.

THE GOVERNMENT OF INDIA (DISTRIBUTION OF REVENUES)
ORDER, 1936.

With regard to the distribution of income-tax to the Provinces and the States an Order in Council called the Government of India (Distribution of Revenues) Order, 1936, has been issued which provides (omitting portions not relevant to this subject) as follows :

Whereas by sub-section (1) of Section 138 of the Government of India Act, 1935, it is provided that taxes on income other than agricultural income shall be levied and collected by the Federation, but that (subject to the provisions of the said sub-section with respect to surcharges for Federal purposes) a percentage to be prescribed by His Majesty in Council of the net proceeds in any financial year of any such tax, except in so far as those proceeds represent proceeds attributable to Chief Commissioners' Provinces or to taxes payable in respect of Federal emoluments, shall be assigned to the Provinces and to the Federated States, if any, within which that tax is leviable in that year, and shall be distributed among the Provinces and those States in such manner as may be prescribed by His Majesty in Council:

And whereas by sub-section (2) of the said Section 138 the Federation is, notwithstanding anything in sub-section (1) of that section, authorised to retain out of the moneys assigned by the said sub-section (1) to Provinces and States—(a) in each year of a period to be prescribed by His Majesty in Council such sum as may be so prescribed; (b) in each year of a further period to be so prescribed a sum less than that retained in the preceding year by an amount, being the same amount in each year, so calculated that the sum to be retained in the last year of the period will be equal to the amount of each such annual reduction :

His Majesty is pleased, by and with the advice of His Privy Council, to order, and it is hereby ordered as follows:—

5. The percentage which under sub-section (1) of Section 138 of the Act is to be prescribed by His Majesty in Council shall

be fifty per cent., and the sums falling to be distributed under that sub-section in any year among the Provinces shall be distributed as follows :

	Per cent.
Madras	.... 15
Bombay	.... 20
Bengal	.... 20
The United Provinces	.... 15
The Punjab	.... 8
Bihar	.... 10
The Central Provinces and Berar	.... 5
Assam	.... 2
The North-West Frontier Province	.... 1
Orissa	.... 2
Sind	.... 2

6. (1) The first of the periods to be prescribed by His Majesty in Council under sub-section (2) of the said section one hundred and thirty-eight shall be five years from the commencement of Part III of the Act and the sum to be retained by the Federation under that sub-section shall, in each of those years, be either the whole of the money assigned by sub-section (1) of the said section to Provinces and States, or such part thereof as will together with—

(a) the Federation's share of the divisible net proceeds of the taxes on income for that year ; and

(b) the sum, if any, to be brought into account by the Federation under sub-paragraph (3) of this paragraph amount to thirteen crores of rupees, whichever is the less.

(2) In this paragraph, "the divisible net proceeds of the taxes on income" means the net proceeds of the taxes on income to which the said section one hundred and thirty-eight relates, except in so far as they represent proceeds attributable to Chief Commissioners' Provinces or to taxes payable in respect of Federal emoluments, or proceeds of any surcharge for Federal purposes.

(3) The sum, if any, to be brought into account by the Federation in any year for the purposes of sub-paragraph (1) of this paragraph shall be a sum to be ascertained by applying to the accounts of the railways, with such alterations in accounts as are necessitated by the separation of Burma, the principles laid down in the Resolution of the Legislative Assembly of the 20th day of

September 1924, and ascertaining in accordance with those principles what sum, if any, would be the net amount payable for that year under Clauses (2) and (3) of that Resolution to general revenues out of the net receipt of the railways :

Provided that for the purpose of ascertaining the net amount so payable to general revenues, borrowings from the depreciation fund before the commencement of Part III of the Act shall be deemed not to be repayable, and arrears of contributions to general revenues for any year before the commencement of the said Part III shall be deemed not to be payable.

7. The second period to be prescribed by His Majesty in Council under sub-section (2) of the said Section 138 shall be five years from the expiration of the first period prescribed thereunder."

Succession : "Change in the Constitution of a Firm."

Section 26 (1) of the Indian Income Tax Act provides that if at the time of making an assessment under Section 23 it is found that a change has occurred in the constitution of a firm, assessment shall be made on the firm and on the members if the firm had been constituted throughout the previous year as it is constituted at the time of assessment. The short question whether when the partners execute a new deed of partnership altering their respective shares in the firm but there is no change in the personnel of the partners, there is a change in the constitution of the firm within Section 26 (1), and whether the partners should in such cases be assessed according to the shares held by them in the year of account or according to the shares at the time of assessment, arose for consideration before the Calcutta High Court in a recent case *Moolji Sicka, In re* (reported below at p. 234). The Commissioner was of opinion that there is a change in the constitution of the firm in such cases, but the Court (DERBYSHIRE, C. J., KHUNDKHAR, J., and MUKHERJEA, J.) held otherwise. In their Lordships' view unless there is a change in the personnel of the partners there is no change in the constitution of the firm. Their Lordships say that in Sections 38 and 63 of the Partnership Act the same expression occurs, and it is used in this sense. They also refer to the meaning given to the word 'constitution' in *Murray's New English Dictionary* and say that from a consideration of that definition the expression would suggest a change in the partners but not a change in the proportion in which the partners divided the profits. The

meaning given in this Dictionary is "The way in which anything is constituted or made up; the arrangement or combination of its parts or elements as determining its nature and character; make, frame, constitution." So far as this definition is concerned it does not seem to support the conclusion of the learned Judges. The sections of the Partnership Act referred to do not also throw much light. The matter is not free from doubt.

Business Expenditure : Sharing of profits.

The difference between a payment out of profits and conditional on profits being earned and a payment to earn profits was recently discussed by the Lahore High Court in *Gopinath Virbhan' Case* (reported below at p. 243). The assessee entered into an agreement with another company by which he agreed to get all his cotton pressed by the company and the company agreed not to do pressing work for any other customer. The assessee was to pay ginning charges at a certain rate and also $\frac{1}{3}$ rd of his net profits in his cotton and seed business. The company was not to be liable for any losses. This $\frac{1}{3}$ rd share was also called 'ginning charges' in the agreement and the assessee claimed that the share of the profits paid to the company under this agreement was business expenditure. Their Lordships held that the payment was not an admissible deduction as a payment incurred by the assessee to earn the profits. They held that by the agreement the assessee and the company had started a *quasi* partnership business in which the company was to receive certain definite sums as ginning charges and was in addition to receive a certain share of the profits.

It is clear from the latest pronouncement on the subject by the Judicial Committee in the *Indian Radio Co.'s Case* (5 I.T.R. 270) that there is no invariable rule of law that a payment out of profits and conditional on profits being earned can never be business expenditure. It has to be determined from all the circumstances of the case whether the payment though based on a proportion of the profits is really made by one of the parties to carry on his business or whether there is really a sharing of the profits of a joint venture. The law on the subject is contained in LORD MACMILLAN's oft-quoted and much misapplied dictum in the *Pondicherry Case*, its explanation in *Adamson's Case* (16 Tax Cas. 293) and in *Tata Hydro Electric Co.'s Case* (5 I.T.R. 203) and the recent pronouncement of the Judicial Committee in the *Indian Radio Co.'s Case* [5 I.T.R. 270].

Hindu Undivided Family : Partial Partition and Registration as Firm.

In *Sir Sundar Singh Majithia's case* (to be reported shortly) the Allahabad High Court has made some pronouncements on the important question whether it is open to the members of a Hindu undivided family to enter into a partnership in respect of a portion of a joint property which they have partitioned among themselves, and to have that partnership registered as a firm under Section 26A of the Income-tax Act. Their Lordships are said to have expressed the opinion that the language of Section 25A makes it perfectly clear that an order declaring separation shall only be passed if (i) the members of the family have separated in status from each other and (ii) there has been a partition of all the joint family property, and that notwithstanding a partial partition and formation of a firm the family would continue to be a single unit for the purpose of assessment under the Income-tax Act. We are awaiting with great interest the full text of the judgment delivered in this case as the question is one of vital importance to the public.

As at present advised we entirely fail to see any justification whatever for the income tax authorities to ignore the legal results of a partial partition which is permitted by the Hindu law.

Section 25A prescribes the procedure to be followed when there is a complete partition. But this does not mean that the income-tax authorities are entitled to ignore the legal effect of a partition of a property owned by the family. The question that arises in such cases is similar to cases of alienation or gift made by the family—whether the income in question continues to be the income of the undivided family within Section 3 of the Act. Partial partition removes the property divided from the ownership of the undivided family and the income of the property divided ceases under law to be the income of that family within Section 3. The real owners of that income namely the firm alone can be assessed in respect of that income under Section 3. It is only when the members of a family claim that a general partition has taken place and the undivided family itself has ceased to exist that any necessity arises to invoke Section 25A.

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A REVIEW OF THE CHANGES PROPOSED BY THE INCOME TAX AMENDMENT BILL, 1938.

The changes proposed by the Income Tax Amendment Bill which has been introduced in the Legislative Assembly are considered below under the following headings :

Application of the Act.	Income Tax Authorities.
Accounts and Accounting.	Income Tax Practitioners.
Agricultural Income.	Interest Payments.
Allowances.	Life Insurance.
Generally.	Local Bodies.
Depreciation of Machinery.	Losses.
Interest on Borrowed Capital.	Non-Residents.
Obsolescence.	Notice of Demand.
Appeals.	Offences.
Associations.	Penalty.
Bad Debts.	Place of Assessment.
Best Judgment Assessment.	Powers of Income Tax Officers.
Charitable and Religious In-	Property Income.
stitutions.	Provident Funds.
Companies.	Rectification of Mistake.
Co-owners.	Refunds.
Deduction at Source.	Returns of Income.
Discontinuance of Business.	Salaries.
Double Taxation Relief.	Succession.
'Escaping Assessment'.	Super-tax.
Firms.	Total Income.
Heads of Income.	Transfer of Assets Abroad.
Husband and Wife.	Trusts and Trustees.

The alterations to which we would refer first relate to the APPLICATION OF THE ACT.

At present under the provisions of Section 4 the Act applies to income which accrues or arises or is received or is deemed to

accrue or arise or be received in British India and, in addition, in the case of a resident, to income accruing or arising outside British India if received in or brought into British India. The Bill enlarges the scope of the section by including—

(1) the whole of the foreign income of a person resident and domiciled in British India whether brought into British India or not ;

(2) the whole of the foreign income from business, profession or vocation of a person resident but not domiciled in British India whether brought into British India or not. The other foreign income of such a person remains liable only if brought into British India.

These amendments follow the provisions of the United Kingdom law except in respect of the foreign income of domiciled and resident persons other than income from business, securities, stocks, shares or rents. Such income in the United Kingdom is taxed on the remittance basis whereas the Bill proposes to tax it on the accruing or arising basis. The United Kingdom provisions in regard to this class of income were not followed because in practice they have given rise to difficulties.

Secondly, the Bill introduces the Slab System. Under the present system of rates of Income-tax, tax is charged at the same rate on the whole income. Under the slab system progressive rates are applied to successive slices of income.

As regards ACCOUNTS AND ACCOUNTING the definition of "previous year" is amended so as—

(1) to allow an assessee to have separate previous year for each separate source of income ; (2) to prevent double assessment of the same profits when the assessee exercises the option to change his "previous year" for the first time after his first year of assessment ; (3) to prevent double assessment of the same profits in the case of a newly set up business ; (4) to prescribe the "previous year" of the firm as the partner's "previous year" in respect of his share. [Section 2, Clause (11)].

In the matter of AGRICULTURAL INCOME an important change is made by the omission of the proviso to sub-sec. (2) of Section 4 exempting income from agriculture in an Indian State.

With regard to ALLOWANCES generally, five new sub-sections (3) to (7) are added in Sec. 10 after sub-sec. (2). *Sub-sec. (3)* gives in the case of assets not wholly used for the purposes of the business a proportionate part of the allowance for insurance premia, repairs, depreciation and obsolescence. *Sub-section (4)* repeats the present

proviso to Section 10 (2) (*ix*) forbidding the allowance of cesses, rates or taxes on business profits and also forbids (a) the allowance of sums chargeable under the head "salaries if payable without British India" and tax is not deducted therefrom, (b) payments by a firm to any partner and (c) payments by an employer to a Provident or other such fund if he has not made effective arrangements to have tax deducted from payments made from the fund.

The disallowance of salary payments abroad is repeated in Section 12 (2), proviso (c)—(Clause 12). The disallowance in respect of Provident Funds is necessary because in practice it is found that payments of accumulated balances from such fund are made abroad and the Income-tax authorities have no means of recovering tax on them.

Sub-section (5) contains definitions the chief of which is the definition of "written down value" for the purpose of depreciation and obsolescence allowances. 'Plant' is defined as including books purchased for the purpose of the business, profession and vocation. *Sub-section (6)* makes liable to tax the profits of a trade, professional or similar association performing services for its members for remuneration. *Sub-section (7)* repeats sub-section (3) of Section 11.

Substantial alterations are proposed in the matter of *Depreciation, Interest on borrowed capital and Obsolescence*.

As regards *Depreciation*: Sec. 10 (2) (vi) as amended alters the basis upon which depreciation allowance is to be calculated from the "original cost" to the original cost less the sums previously allowed for depreciation, and except in the case of unabsorbed depreciation which the assessee is entitled at the commencement of the amending Act to carry forward to a succeeding year, it treats depreciation on the same footing as any other expense of the business. Consequently depreciation for any year subsequent to the commencement of the amending Act can only be carried forward for as long as any other loss can be carried forward. But the unabsorbed depreciation at the commencement of the amending Act may be carried forward until fully allowed and is to be allowed before the depreciation due in respect of subsequent years. In practice the assessee writes off in his accounts much less than the amount of depreciation at the prescribed rates. Proviso (b) to Section 10 (2) (vi) has therefore been amended so as to restrict the allowance for depreciation to the amount written off in the assessee's accounts.

(2) A new provision grants depreciation on machinery, plant and furniture let out on hire. If the business of the assessee is letting machinery, plant and furniture on hire he will be entitled to the allowance under the provisions of Section 10 (2) (vi) [Sec. 12 (3)].

With regard to *Interest on Borrowed Capital* :

Sec. 10 (2) (iii) as it now stands allows interest on capital borrowed for the purposes of the business subject to the condition that the payment of interest is not in any way dependent on the earning of profits. The amendment deletes this latter condition but withdraws the allowance to a firm in the case of interest paid to a partner and to any assessee in the case of interest payable without British India (not being on a public loan issued before 1st April 1938) except interest from which tax has been deducted [See Section 9 (1) (iv), Clause 9].

In the matter of *Obsolescence* :

This allowance is now to be given in respect of any machinery or plant sold or discarded and is to be the difference between the excess of the written down value over the sale price or scrap value provided that this amount is written off in the books of the assessee. Any excess of the sale price or scrap value over the written down value is to be treated as an assessable profit.

Clause 34 of the Bill extends the scope of APPEALS. Provision is made for appeal in the following cases:—Assessment under Section 23 (4); assessment resulting in loss; refusal of refund or full refund under Sections 48, 49, 49B or 49C (Section 50A then becomes superfluous and is deleted—clause 57). Provision is also made to prevent an assessee questioning an assessment on a firm or an order under Section 23A in respect of a Company otherwise than in an appeal against the firm's or the Company's assessment.

Provisions relating to the hearing of appeals are amended so as to give power to the Appellate Assistant Commissioner to admit fresh grounds of appeal and to direct the Income-tax Officer to amend the assessments of partners of firms or members of associations in accordance with the appellate orders in the firm's or association's assessment. He is also given power to enhance a penalty. The Income-tax Officer is given the right to be represented at the hearing of an appeal. Owing to the institution of separate Appellate Assistant Commissioners it is considered necessary for the Department to be so represented. Section 33A which prescribes the reference to a Board of Referees of an order under Section 23A is deleted. Owing to the amendment of Section 23A

(clause 24) it is considered that this section is unnecessary and that the appeal can be heard by the Appellate Assistant Commissioner in the ordinary way.

Section 66 is also amended so as to allow the High Court in cases of appeal to the Privy Council, where a refund of the tax to the assessee who has succeeded before the High Court is inadvisable, to authorise the Commissioner to withhold the refund.

As regards ASSOCIATIONS: (i) throughout the Act the words "association of persons" are substituted for "association of individuals" in order to cover all cases of associations of persons; (ii) it is also provided that co-owners holding definite shares shall not be assessed as an association but as individuals, their shares being included in their individual assessments.

Provision has been made with regard to BAD DEBTS by the insertion of a new clause, Cl. (xi), to Sec. 10 (2) which provides that where the accounts are not kept on the cash basis such sum in respect of bad and doubtful debts as the Income-tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off as irrecoverable by the assessee may be allowed: Provided that if the amount ultimately recovered on any such debt is greater than the difference between the whole debt and the amount so allowed the excess shall be deemed to be a profit of the year in which it is recovered.

As regards BEST JUDGMENT ASSESSMENT, (i) an important amendment allowing appeals from such assessments is proposed. (ii) Further, Section 23 (4), as amended, will not apply to a person who makes a return under Section 22 (3). (iii) In the case of assessment under this sub-section there has hitherto been no provision in terms for refusal of registration to a firm. This has also been remedied.

Section 27 which becomes unnecessary owing to the amendment of Section 30 allowing an appeal against an assessment under Section 23 (4) has been omitted.

Sub-section (1) of Section 10 brings income from professions and vocations under the same head as income from BUSINESS. [Section 11 (clause 11) is deleted].

The exemptions in the Act at present do not in terms apply to income from business carried on by religious or CHARITABLE INSTITUTIONS though in practice such exemption is given. An amendment gives legal authority for the practice but confines the exemptions to cases where the business activities are in themselves a primary purpose of the institution or the work in

connection with which the business is mainly carried on by the beneficiaries. An amendment is added to prevent the abuse of the exemption given to the income of religious trusts. It prescribes that the exemption shall not be given to income of a private religious trust which does not enure to the benefit of the public.

With regard to COMPANIES in general three amendments have to be noted :

(i) Section 2 Clause (6A), a new provision, defines "dividend". To prevent the avoidance of super-tax which would otherwise be payable by the shareholders by the device of distributing the profits in the form of bonus shares, bonus debentures or some other form which, as the law stands at present, are capital receipts and not income in the hands of the shareholders, dividend is defined in such a way that wherever the shareholders receive profits in any of such forms it can be treated as income for tax purposes. The definition also covers the case where a Company goes into liquidation and the accumulated profits are distributed by the liquidator to the former shareholders. Income is then defined in Section 2, clause (6C), to include any dividend as defined in Section 2, clause (6A), and also to include distributions from unrecognised Provident Funds.

(ii) Sub-section (2) (a) of Section 14 exempts from taxation dividends of companies whose profits have been assessed to tax. This provision needed amendment as the result of a Privy Council decision that it exempts the whole dividend even when only part of the Company's profits have been taxed. Instead of amending it, it has been decided to delete it and amend Section 16 (2) and Section 18 (5). The result of these changes will be that a dividend will no longer be exempt. It will be on the same footing as interest on securities and credit for the appropriate amount of tax on it will be given in the assessment.

(iii) Section 23A of the Income-tax Act, 1922, imposes upon an Income-tax Officer the duty of determining whether the profits and gains of a Company are allowed to accumulate beyond its reasonable needs, existing and contingent, having regard to the maintenance and development of its business. The present clause substitutes a simple arithmetical criterion for the determination of the applicability of the section to the circumstances of a Company in any year. Subsidiary Companies, and Companies in which the public are substantially interested are still excluded from the operation of the section, but the opportunity has been

taken to amend the definition of "Subsidiary Company" so as to remove any doubt as to the meaning of the expression "a Company not being a company to which the provisions of this sub-section apply." The clause also alters the procedure under the section. Instead of passing an order to the effect that the sum payable as income-tax by the Company shall not be determined and that the proportionate share of each member in the profits and gains of the Company shall be included in his total income, the Income-tax Officer has under the present clause merely to deem the profits of the Company to have been distributed as dividends on a given date. The assessment of a Company to both income-tax and super-tax will therefore be made whether or not an order is passed under the section in its proposed new form.

As to Co-OWNERS when property is owned jointly by persons with definite shares the High Courts have held that such persons are assessable on the income from the property as an association of individuals. The Bill provides that such persons shall not be assessed as an association but that their shares will be included in their individual assessment (Section 9 Sub-section 3).

Section 18 which deals with DEDUCTION OF TAX AT SOURCE is amended in the following ways :

(i) *Sub-section (2)* as amended provides for deduction of super-tax at source from "salaries" and is otherwise amended to conform with the "slab" system of rates.

(ii) *Sub-section (2B)*, a new provision provides for the deduction of income-tax at the maximum rate and super-tax at source from "salaries" payable to non-residents.

(iii) *Sub-section (3A)*, a new provision, provides for deduction of tax at source from interest and other payments made to non-residents. In the case of residents it is not advisable to make such deduction because of practical complications, but in the case of non-residents it is advisable to secure the tax in this way if it can be done. When deduction at source is not practicable, the payments will be disallowed in the payer's assessment (clauses 9, 10 and 12). Consequential amendments are made in sub-sections (3B), (3C) and (3D) [which are renumbered (3C), (3D) and (3E)].

(iv) *Sub-section (5)*, as amended, includes income-tax on a dividend as a sum for which credit is to be given to the shareholder in his assessment (see notes on clauses 14 and 51).

(v) *Sub-section (7)*, as amended provides, in the case of tax not deducted at source under sub-sections (3D) and (3E), for its recovery from the company as well as from the principal officer,

(v) Section 19 is expanded in consequence of the amendment of Section 18. Income-tax shall be payable by the assessee direct if not deductible and deducted under Section 18.

Section 44 which relates to DISCONTINUANCE OF BUSINESS is expanded so as to include cases of business, profession or vocation discontinued by an association of persons as well as a firm and makes members of such an association liable to assessment on the firm's or association's profits as well as for the tax payable.

As regards DOUBLE TAXATION RELIEF Section 49 which deals with double income-tax relief is amended to accomplish the following objects :—Relief is restricted to half the Indian rate; the relief granted to the Company is taken into account in computing the refund admissible to the shareholder under Section 48; and any excess relief granted to the Company over the relief admissible to the shareholder can be recovered from him. These amendments are designed to prevent any assessee getting more relief than he is entitled to.

Important changes have been introduced in Section 34 which deals with income ESCAPING ASSESSMENT : (i) The most important change is the extension of the period for making such assessments from one year to six years. This follows the United Kingdom law and in conjunction with compulsory returns (clause 22) and penalties (clause 32) it is expected to be a very effective provision for dealing with illegal evasion. (ii) Owing to a recent decision of the Calcutta High Court which narrowly restricts the scope of Section 34 it is considered necessary to amend it so as to make it clear that it is applicable where the Income-tax Officer is of opinion that income has escaped assessment. This amendment follows Section 22 (2) which has given rise to no difficulty in practice. (iii) The section is also amended so as to remove any doubts as to its applicability to cases of under-assessment. (iv) At present there is no time limit for the completion of assessment proceedings begun in time. Sub-section (2) provides that they shall be completed within the period of six years from the end of the assessment year.

The material amendments with regard to FIRMS are :

(i) Section 3 has been amended to enable assessment to be made on individual partners of firms or on individual members of associations of persons.

(ii) Sub-section (5) of Section 23, a new sub-section, provides that in the case of a registered firm the partners and not the firm are to be assessed and that the partners of an unregistered firm

may be assessed in the same way if they are avoiding tax by non-registration. A partner's share is to be his share of the previous year's profits (compare clause 14 and clause 30) and he may carry forward his share of loss. The firm is to be assessed on a non-resident partner's share.

(iii) *Sub-section (2), clauses (b) and (c) of Section 14* exempt the proportionate shares of the taxed profits of firms and associations of individuals. Since it has been decided [Section 23 (5)] to tax the partners of registered firms directly, this sub-section as amended relates only to unregistered firms and it exempts not the amount (which is now exempted) of the firm's profits proportionate to the assessee's share therein at the time of making the assessment but the proportion of the firm's taxed profits which the assessee is entitled to receive. This change is made in pursuance of a decision to take as the basis for income-tax purpose the actual shares of the previous year. The same principle has been adopted in amending Section 26 (clause 30). *Sub-section (2) (c) of Section 14* as now amended exempts not the amount which a member of an association receives but the amount that he is entitled to receive.

(iv) The inclusion of a minor admitted to the benefits of partnership in the expression "partner" has obviated further reference to him in the Act.

HEADS OF INCOME are now reduced to 5. Section 6 specified six heads of chargeable income. They are now reduced to five owing to the amalgamation of Sections 10 (business) and 11 (profession or vocation).

HUSBAND AND WIFE are to be assessed separately at the rate applicable to the total income of both, subject to an allowance up to Rs. 500 in the case of income earned by the personal exertions of the wife. [Section 17 (1)].

Clause 6 of the Bill amends Section 5 which deals with INCOME-TAX AUTHORITIES. It has been decided to divide Assistant Commissioners of Income-tax into Appellate Assistant Commissioners and Inspecting Assistant Commissioners and to place the former under the control of the Central Board of Revenue. This clause amends Section 5 accordingly and in addition includes amongst Income-tax authorities Income-tax Inspectors who are to have power to enter premises to make enquiries. [Section 38 (2)].

Regarding INCOME TAX PRACTITIONERS Sec. 61 is amended to correct abuses in respect of the representation of assesseees. The new provisions give the assessee a wide field from which to choose

his representative. The amended Section does not affect existing INCOME-TAX PRACTITIONERS, however incompetent, so long as they are not guilty of misconduct in connection with income-tax proceedings [Cl. 72].

Cl. 20 of the Bill reduces from Rs. 1,000 to Rs. 200 the minimum amount of the INTEREST PAYMENTS which the payer has under Section 20A to report annually to the Income-tax Officer.

With regard to LIFE INSURANCE, Clause 70 amends Section 59 (which confers rule-making power) so as to remove any doubts as to whether the rules regarding the computation of profits of life insurance business are *ultra vires* in so far as they vary the provisions of the Act. Sec. 15 now gives exemption in the case of life insurance premia and payments to Provident Funds and limits the exemption in respect of those payments and payment to Family Pension Funds to 1/6th of total income. In the case of large incomes this is too generous an allowance and therefore sub-section (3) as amended limits it to Rs. 6,000.

At present all income of LOCAL AUTHORITIES is exempted. If a local authority makes profits from supplying a commodity or service outside its jurisdiction it is considered that exemption should not be given to those profits and this amendment gives effect to that view. [Sec. 4 (iii)].

The Bill introduces a major change in the matter of LOSSES by allowing the carry forward of losses.

(i) Sub-section (1) of Section 24 is amended by a proviso which does not allow any of the partners of an unregistered firm to set off any part of the firm's loss against their incomes. In the case of a registered firm the loss that cannot be set off in the firm's assessment shall be apportioned amongst the partners who alone will be entitled to set off the loss.

(ii) Sub-section (2) allows losses in a business, profession or vocation to be carried forward and set off against the profits of the *same business, profession or vocation*. The period of carry forward is to be six years but to mitigate the effect on the revenue of this concession losses of the first "previous year" after the commencement of the Amending Act are to be carried forward for one year, losses of the next year for 2 years, and so on until the full period of 6 years is reached.

(iii) The provisions regarding registered and unregistered firms in sub-section (1) are *mutatis mutandis* repeated in Sub-section (2) and in accordance with the principle given effect to elsewhere that the liability or benefit should attach to the person receiving the

profits or incurring the loss it is provided that in the case of a change in a firm's constitution or a succession only the person incurring the loss will be able to set it off.

Sub-section (3) provides for the computation of the loss in an order in writing and its communication to the assessee (See clause 34).

With regard to NON-RESIDENTS the main alterations are:—

(i) Clause 45 amends Section 42 which deals with the income of non-residents accruing or arising without British India but deemed to accrue or arise within British India. At present sub-section (1) applies to income accruing or arising through or from any business connection or property in British India. In order to bring within the net of taxation all income arising in a primary sense from British Indian sources, the sub-section has been amended so as to include income accruing or arising "from any asset or source of income in British India or through or from any money lent at interest and brought into British India in cash or in kind".

(ii) Sub-section (1) has also been amended so as to make it clear that either the non-resident or his agent may be assessed and so as to allow the agent to retain enough of his principal's moneys to pay the tax.

(iii) Sub-section (2) has been amended so as to put a British subject or subject of an Indian State in no worse position than a non-British subject or person who is not a subject of an Indian State.

(iv) Sub-section (3), a new provision, narrows the scope of the whole section by confining it to that part of the profits attributable to operations in British India.

(v) Section 40 is amended so as to make it clear that an assessment can be made on a non-resident direct instead of on his resident agent. Further, in order to cover all cases, it changes the basis of assessment on the guardian, trustee or agent from assessment on what he receives to assessment on what he is entitled to receive, on the beneficiary's behalf. [Cl. 45].

(vi) Remittances made by a non-resident husband to a resident wife are taxable..

Section 17 (2) and (3), determine the tax payable by non-residents with non-taxable foreign income and persons with exempted income which is included in total income. The principle adopted is to calculate the tax (including super-tax) on the whole income of the assessee and levy that proportion of it which the liable income bears to the whole income. The important point

about this amendment is that the rate applied to the taxable income is the rate applicable to the whole income. In the case of non-British non residents income-tax will be payable at the maximum rate.

(vii) The definition of "total income" is amended and the clause as amended includes a definition of "total world income" which is necessary for the purpose of assessing non-residents. *Section 2, Clause (15)*.

Clause 33 of the Bill makes an amendment in Section 29 (NOTICE OF DEMAND) consequent on the amendment made by clause 53 (b) and provides also for the issue of a notice of demand where the Central Government succeeds before the Privy Council.

As to OFFENCES (i) Section 52 is so amended as to make it clear that action under any relevant section of the Indian Penal Code is also open to the Income tax authorities.

(ii) Clause 61 amends Section 54 which forbids disclosure of information contained in income tax proceedings. Certain self-explanatory clauses are added to the existing clauses which permit such disclosure.

(iii) Annual return of Salaries of employees is made verifiable and untrue statements are made penal.

With regard to income from OTHER SOURCES *Sub-section (2)* of Section 12, as amended disallows interest (other than interest on a public loan issued before 1st April 1938) and 'salaries' payable without British India from which tax has not been deducted.

The section relating to PENALTY (Section 28) is altered with a view to give the Income-tax Department more effective means of dealing with illegal evasion. The penalty is increased from the amount of the tax avoided to twice that amount; it is to include super-tax as well as income-tax and it is to be impossible for failure to file a return or to submit accounts or to submit other evidence in support of a return. To prevent hardship in the case of a person with no income liable to tax the penalty is limited to Rs. 50 and in the case of the agent of a non-resident the penalty for failure to file a return can only follow the issue of a specific notice calling for a return. Provision is also made [proviso (c) to sub-section (1)] to prevent an assessee scenting penalty proceedings from avoiding them by the submission of a return. (Clause 32).

Clause 74 amends Section 64 (3) so as to debar the assessee from questioning the PLACE ASSESSMENT after the time allowed by notice under Section 22 (1) for submitting a return. Assessee frequently obstruct income-tax proceedings by raising questions of

jurisdiction and the amendment is designed to check this practice. The sub-section is also amended so as to make it clear that the Income-tax Officer has to refer to the Commissioner before assessment a question regarding the place of assessment.

POWERS OF INCOME TAX OFFICERS have been extended by important additions to Section 38. Clause 42 gives the Income-tax Officer or Assistant Commissioner power to call for lists of persons to whom rent, interest, commission or the like in any year amounting to more than two hundred rupees is paid. It gives the Income-tax Officer and the Inspector power to visit premises and make enquiries. This only gives legal sanction to existing practice. It also gives the Income-tax Officer power when visiting such premises to call for accounts and stamp them. The object of this provision is to cope with cases in which false accounts are submitted for assessment or in which at the time of assessment the existence of accounts is denied. For failure to comply with the Income-tax Officer's request a penalty is provided in Section 51 (clause 58).

Section 9 which deals with PROPERTY INCOME has been amended in the following respects:—

(i) The exemption given to the property occupied for business purposes is restricted to property occupied for the purpose of an assessable business, profession or vocation.

(ii) At present interest on any capital charge on the property is allowed even though the capital was borrowed for private purposes; and interest on capital borrowed for the purpose of acquiring the property is allowed even though there is no charge on the property. The amended clause (iv) alters the position so as to allow only interest on a charge to which the property was subject at the time of acquisition by the assessee and interest on capital borrowed for the purpose of acquiring, repairing, renewing or reconstructing the property. It further allows—what is not now allowed—an annual charge not being capital charge to which the property was subject at the time of its acquisition by the assessee.

(iii) In order to secure that tax shall be collected on such interest or charges payable outside British India it is provided that no allowance shall be made in respect of them unless tax has been deducted therefrom. There is a similar provision in Section 10 [clause 10 (b) (i), proviso] and Section 12 [clause 12 (b) proviso (b)]. Interest on a public loan issued before 1st April 1938 is excepted.

(iv) The proviso to sub-section (1) which restricts the allowances in respect of property to the amount of the annual value is deleted. As a result a loss on property will be allowed.

(v) The proviso to sub-section (2) which restricts the annual value of owner occupied property to 10 per cent. of its owners' total income is also deleted. This amendment remedies the present anomaly of the annual value of the property varying with the assessee's other income.

With regard to PROVIDENT FUNDS (i) the limit of exemption is cut down to Rs. 6,000 as in Section 15 (clause 15) and in order to simplify the provisions regarding the exemption of interest on the employee's accumulated balance it is provided that such interest shall be exempted in so far as it does not exceed one-third of the employee's salary for the year. [Clause 67].

(ii) It is intended to give the benefits of participation in a recognised Provident Fund only to those employees who have rendered continuous service with the employer for at least 5 years. Section 58C (3) is here amended so as to put the employee belonging to a recognised Provident Fund who has not rendered 5 years' service in the same position as he would have been if the fund had not been recognised. [Clause 68].

(iii) Section 58K (2) is amended so as to ensure that an employer will not be allowed payments which would be disallowed under Section 10 (4) (c) [Clause 69].

Section 38 which relates to RECTIFICATION OF MISTAKES has been amended so as to extend the period for rectification from one year to six years.

Clause 51 of the Bill makes sweeping changes in Section 48 which deals with REFUNDS of tax on dividends, of tax paid by registered firms and of tax deducted at source. The section in its reference to rates is unnecessarily cumbrous; it would no longer apply to registered firms whose partners are to be assessed directly (Section 23 (5)—clause 23) and it leaves the position regarding double income tax relief in doubt. Instead of the main provisions of the section a simple provision has been inserted giving an assessable person (Section 3) a refund of any excess tax paid by him or on his behalf or treated as so paid over the amount with which he was properly chargeable. (As to dividend, see Section 18 (5)—clause 18). The amended section does not require any distinction to be made between British and non-British subjects as their rates of tax are dealt with elsewhere (see Section 17 (2)—clause 17).

Section 48A which the amendment of Section 48 (clause 51 above) makes superfluous is omitted [cl. 52].

The period of limitation for claims to refunds is extended from one year to six years in accordance with a similar extension in other sections (Sections 34 and 35).

Changes of major importance have been made in relation to RETURN OF INCOME:

(i) Section 21 is amended so as to make the annual return of salaries of employees verifiable. A penalty is provided in Section 52 (clause 58).

(ii) A major change is effected in Section 22 by prescribing compulsory returns of income.

(iii) Section 22 (1), as amended, prescribes compulsory returns and Section 22 (2) in consequence makes optional the issue by the Income-tax Officer of the notice, now compulsory, calling for a return of income. This change in the law follows the United Kingdom law and it is intended as in the United Kingdom that the Income-tax Officer should (as he now does) issue notice to each person whom he believes to have an assessable income. The object of the provision prescribing compulsory returns is to enable the Income-tax authorities to deal with defaulters who conceal the fact that they have taxable incomes. It is not considered right that the onus of finding such persons should be on the Income-tax authorities and this provision coupled with the penalty provisions (clause 32) and the extension of the time for initiating assessments (clause 39) is designed to put the Income-tax authorities in a position to deal adequately with defaulters.

(iv) An assessee is allowed by Section 22 (3) to file a return or revised return before assessment is made and so to escape an assessment under Section 23 (4). He is to retain this right but in order to prevent him escaping the consequences of submitting an original false return or evading the penalty for failure to submit a return (clause 32), the closing words of this sub-section have been omitted and a suitable proviso has been inserted in Section 28 (clause 32).

(v) Section 22 (5), a new provision, takes the place of Section 38 (3) which is deleted. It is considered that the following particulars should be furnished as part of the return of income in the case of an assessee engaged in business, viz., location and style of principal place of business and branch businesses, if any, and the names and addresses of his partners and their shares.

With regard to SALARIES (i) Section 7 which deals with income under the head "Salaries" is amended so as to make sums due under that head liable on the date when they are due whether paid or not. Advances and loans of such income are deemed to be salary due on the date when received. The object of this amendment is to defeat evasion by postponing drawal of salary or by taking advances or loans.

(ii) Judicial decisions on the question of the liability to tax of income from "salaries" have made it necessary to make the earning of the salary in British India the basis of the liability. Only pensions payable without India are excluded.

(iii) *Expl.* to Sec. 7 (2) read with the definition of "income" in clause 2 (d) nullifies for the future in respect of the payments with which it deals the effect of the Privy Council decision in the *Shaw Wallace case* (6 I.T.C 178). To mitigate the hardship that would be caused by assessing accumulated payments of this kind at the rate applicable to the total income of the year of receipt an amendment is proposed in Section 60 (2) (clause 71).

On the topic of SUCCESSION: (i) Section 24B is amended in consequence of the amendment of Section 22 (1) prescribing compulsory returns of income (clause 27).

(ii) Section 25 is altered [by amending sub-section (3) and adding a new sub-section (4)] as to give to the first successor to a business, profession or vocation after the commencement of the amending Act the benefit now given by Section 3 to the owner of a discontinued business assessed under the 1918 Act. That benefit, *viz.*, being allowed to substitute the profits from the end of the previous year, is given because otherwise those assessed under the 1918 Act would be assessed for one year more than the number of years the business was in existence. Since clause 30 provides that whenever there is a succession the predecessor shall be assessed on the previous year's profits it is necessary to give this relief to the predecessor in the case of succession to a business assessed under the 1918 Act.

(iii) Sub-section (5) to Section 25 prescribes a period of limitation for claims under sub-sections (3) and (4).

(iv) Section 25A is so amended as to give effect to the principle that the assessment on the profits of the previous years should be made on the person who received the profits—in this case the disrupted Hindu Undivided Family).

(v) Section 26 is amended by giving effect to the principle mentioned in the preceding clause. In cases where a firm has changed its constitution or has been newly constituted or where there has been a succession to a business, profession or vocation except in the case of an unregistered firm (where the partners entitled to the profits get credit for the tax paid) the persons who are entitled to receive the profits are to be assessed on them. Provision is made for assessment on and recovery of tax from the successor in the case where the predecessor cannot be found or where he will not or cannot pay the tax.

Coming to SUPER-TAX, (i) Clause 62 amends Section 55, the super-tax charging section, by exempting a member of an association of persons from super-tax where the income of the association has been assessed to super-tax; (ii) it also takes out of the exemption given to partners of unregistered firms the case (Section 23 (5) (b)—clause 23) of unregistered firm assessed as a registered firm; (iii) Old Sec. 57 makes the resident partners of a firm responsible for the super-tax on a non-resident's share of profits. The amended Section 23 (5) (a) [clause 23 (b)] makes this section superfluous and it is therefore omitted. (iv) Consequential amendments are made in Section 58 which deals with the application of the provisions of the Act to super-tax.

Section 16 which specifies certain sums which are to be included in "TOTAL INCOME" is amended in the following ways by Clause 16:—

(i) *Sub-section (1) (b)*, a new provision, prescribes the way in which the share (whether profit or loss) of a partner in a firm is to be computed. This method of computation follows the amendment of Section 10 (4) (b), (clause 10) disallowing in the firm's assessment payments to partners.

(ii) *Sub-section (1) (c)*, is an important provision designed to prevent the avoidance of tax by the simple device of settling income upon another person whose rate of tax is lower than that of the settlor, or the transfer as assets, so that the income therefor arises to such other person. This amendment provides that the income in such a case is to be treated as the income of the settlor or transferor. Where, however, the assets are irrevocably transferred to another person, other than in the circumstances dealt with in sub-section (3) (b) or in clause 48, the income therefrom is not to be deemed to be income of the transferor.

(iii) *Sub-section (2)* of Section 16 provides for the inclusion in "total income" of the tax on the dividend along with the dividend. As amended it provides for the inclusion in "total income" of only the appropriate amount of tax in the case of a dividend from partly taxed profits (see note on clause 14). The form of the sub-section has been altered to suit the definition of "dividend" in Section 2 (6A), (clause 2).

Sub-section (3) (b)—The wording of this clause has been found to be defective as it may be possible for a person to transfer income to an association of individuals which includes a person other than that individual or his wife but in such circumstances that the income becomes the income of the wife or minor child. For this reason the words “consisting of such individual and his wife” are being omitted and the words “for the benefit of his wife or a minor child or both” are being added. It will be seen that the provisions in sub-section (1) (c) cover all cases of transfers of income and also cover cases of revocable transfers of assets. This clause as now amended covers the further cases of irrevocable transfers of assets where the income accrues to the benefit of the wife or minor child of the transferor.

A new chapter dealing with a particular type of evasion, viz., **TRANSFER OF ASSETS ABROAD** has been introduced by clause 48. One of the methods of avoiding the payment of tax without breaking the law is to transfer the assets from which the income arises to a Company which is resident outside British India; and then to receive payments from that Company in a form and in such circumstances that the amounts received from the Company are never in fact repayable or repaid to it. The effect of these arrangements is that the real owner of the assets receives the income therefrom indirectly and in a capital form. These receipts cannot, as the law stands at present, be treated as income in the hands of the recipient, nor, since the Company is a non-resident Company, can it be subjected to the provisions of Section 23A which deals with a Company which, to enable its proprietor to avoid super-tax, fails to distribute its income. The object of Clause 48 of the Bill is stated to be to prevent the loss of tax through such devices. The clause has been drafted in wide terms and follows the wording of Section 18 of the United Kingdom Finance Act, 1936. Its terms are very comprehensive, and the net effect intended is that whatever income which really belongs to a person liable to income tax and super-tax becomes by means of an artificial set of transactions the income of somebody liable to pay less tax or no tax at all, such income can for tax purposes be treated as the income of the person to whom it really belongs.

With regard to **TRUSTS** alterations are made in Sec. 41 corresponding to those made in Sec. 40 (See *Non-residents* above). In addition the amendment makes trustees assessable in respect of the trust income and provides for assessment at the maximum rate of income chargeable under the section which is not specifically the income of a beneficiary or where the individual shares in the income are indeterminate or unknown. In the other cases the income will be assessed at the rate applicable to the individual beneficiary. Provision is also made for cases where part only of the trust income is chargeable. [Clause 44]. New provisions as to religious and charitable trusts have been already referred to.

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PART XII.

NOTES & COMMENTS.

The Privy Council on Fresh Assessments and Commissioners' Powers of Revision Under Section 33—(*Khemchand Ramdas' Case*).

The Judgment of the Judicial Committee in *Commissioner of Income Tax, Bombay v. Khemchand Ramdas* which was pronounced on the 7th April, 1938 (reported below at p. 414 ff.) contains some pronouncements of general importance on the validity of fresh assessments and the powers of the Commissioner under Section 33 of the Indian Income Tax Act.

FRESH ASSESSMENTS.

It was laid down by the Judicial Committee in *Rajendra Nath Mukherjee's Case* [1934, 2 I.T.R. 71] that the Act nowhere imposes any limit of time within which an assessment under the provisions of Sections 23 and 29 is to be made and that the service of the notice of demand can, therefore, be made at any time. Their Lordships, referring to this case, said that though this is true, "it is not true that after a final assessment under those sections has been made the Income Tax Officer can go on making fresh computations and issuing fresh notices of demand to the end of all time". In their Lordships' opinion it is impossible to suppose that the Income Tax Officer may in every kind of circumstance and after any lapse of time make fresh assessments or issue a fresh notice of demand or that the Commissioner can direct him to do so.

SCOPE OF SECTION 33.

With regard to the scope of Section 33 of the Act, which empowers the Commissioner to call for the record of any proceeding and to make such enquiry and to pass such orders thereon as he thinks fit, the Judicial Committee are of opinion that "The Commissioner's powers under Section 33 can only be exercised subject to the provisions of the Act, of which the provisions in Sections 34 and 35 are in this respect of the greatest importance." In their Lordships' opinion "the provisions of Sections 34 and 35 are exhaustive and prescribe the only circumstances in which and the only time in which such fresh assessments can be made and fresh notices can be issued."

The last sentence quoted above, especially if we read it without laying sufficient emphasis on 'such' is liable to be misconstrued. 'Such', here means fresh assessments of the nature

specified in Sections 34 and 35 and their Lordships, we think, only mean that no fresh assessment of such a nature can be made in pursuance of an order in revision except in the circumstances mentioned in Sections 34 and 35.

Appeal From Best Judgment Assessment.

The Judicial Committee have also held in the above mentioned case [*Khemchand Ramdas' Case*] that though an assessment purports to be one made under Section 23 (4) an appeal would lie if it is really one not under that provision of law, but one under another provision, e.g., Section 34 or 35. Their Lordships have quoted with approval the observation made by SIR SHADI LAL in a Punjab case that "The mere fact that the assessment purports to have been made under that sub-section [Section 23 (4)] does not shut out the appeal; it must be shown that the circumstances of the case bring it within the scope of that sub-section".

As a corollary it also follows that the Commissioner cannot, by deciding that an assessment was one under Section 23 (4) and quashing an appeal therefrom as incompetent, deprive an assessee of his right to have the question whether the order was appealable referred to the High Court.

Now that the Amendment Bill proposes to make an assessment under Section 23 (4) also appealable the question loses much of its importance. (Vide Clause 34 of the Income Tax Amendment Bill).

Meaning of 'Assessment'.

The Judicial Committee's observations in *Khemchand Ramdas' case* on the meaning of the word 'assessment' are very instructive. "One of the peculiarities of most Income Tax Acts", their Lordships say, "is that the word 'assessment' is used as meaning sometimes the computation of income, sometimes the determination of the amount of tax payable and sometimes the whole procedure laid down in the Act for imposing liability upon the tax payer. The Indian Income Tax Act is no exception in this respect". This statement of their Lordships is sure to prevent the confusion that might arise from reading the Act without realising that the word is used in these three senses.

Profits Derived From Sale of Shares and Securities.

The Lahore High Court had recently occasion to consider again the law applicable to cases where a business concern derives profits from the sale of shares and securities in which it had invested its funds (Vide *Punjab Co-operative Bank Ltd. v. Commissioner of Income-tax, Punjab*, 1938, 6 I.T.R. 355, June 1), and the High Court has again come to the conclusion it had arrived at in

Amritsar Produce Exchange Co., Ltd., In re (1937, 5 I.T.R. 307) that in every case that arises it is to be determined on its own facts whether the investment was a part of the ordinary business of the investor or otherwise. It is not possible to lay down a rule of general application that in every case an investment in securities should be treated as fixed capital. If the investment was a part of the business of the assessee, profits derived therefrom would be income from business and assessable to tax. On the other hand, if it could be found that an investment had been made for the purpose of permanently excluding a certain sum from the floating capital of a concern, it would be permissible to hold that that sum had no concern with the stock-in-trade and that the profits were in the nature of capital.

The fact that the profits had not been utilised in the revenue account but carried to the reserve capital *en bloc* is not by itself inconsistent with the profits being trading profits and the finding of the income tax authorities would in such cases be conclusive if based on relevant evidence.

Withdrawal of Appeal to Prevent Enhancement of Assessment.

The interesting question whether an assessee who has preferred an appeal to an Assistant Commissioner is entitled to withdraw the appeal so as to prevent the Assistant Commissioner from enhancing the assessment in the exercise of his powers under Section 31 (3) (a) and (b) of the Income Tax Act has been answered in the negative by the Lahore High Court in the case of *Commissioner of Income Tax, Punjab v. Nawab Shah Nawaz Khan* (1938, 6 I.T.R. p. 370). Their Lordships are of opinion that the method of disposing of appeals is defined in Section 31 of the Act. It does not confer any right on the assessee to withdraw the appeal but empowers the Assistant Commissioner to enhance the assessment. The assessee cannot be assumed on general principles to have the power to withdraw for it would nullify the Assistant Commissioner's power to enhance by preventing him from proceeding with the appeal. The conclusion seems to derive support from *Elmhirst ex parte*; *R. v. Special Commissioners* [1936, 1 K. B. 487] in which the assessee's right to withdraw was negated in similar circumstances.

It is however important in this connection to note that in exercise of the power of enhancement the Assistant Commissioner cannot override the limitations imposed by Section 34. He cannot add new items of income which had escaped, after the expiry of one year.

Transfer of Business: Transferor's Right to Set off Loss:—*B. K. Paul & Co., In re* [1938 I.T.R. 395].

The Calcutta High Court has elaborately considered the difficult question that arises when a business which has suffered loss is transferred, *viz.*, whether the transferor is entitled to set off the loss which he has sustained against his profits notwithstanding Sec. 26 (2) which provides that the assessment in such cases is to be made on the transferee. In this case the transferee had no profits to be assessed and the High Court, relying on the decision of the Bombay High Court in *Bhogilal Hargovindas Patel's case* (1937 I.T.R. 555) held that where the transferee has no income and he cannot be assessed, Section 26 (2) has no application at all and under the provisions of Section 14 the transferor would be entitled to set off the loss against his income. Where the transferee has income and has to be assessed complicated questions would arise but their Lordships considered it unnecessary to anticipate and decide them in this case. This question also loses much of its importance hereafter owing to the recommendation of the Enquiry Committee, (which has been adopted in the Income Tax Amendment Bill Cl. 30) to redraft Section 26 (2) altogether so as to make the persons entitled to receive the profits assessable in respect of the profits where there has been a succession to a business. Under the Bill the successor will be assessable only if the predecessor cannot be found or cannot pay the tax.

Flat Rate Assessment.

Ganeshi Lal & Sons, Agra v. Commissioner of Income Tax U. P. [1938 I.T.R. 390] is an interesting case in which a flat rate assessment at 30 per cent. and an assessment of profits at 60 per cent. on the sale of a particular article of jewellery was upheld by the High Court. This decision shows that if an Income Tax Officer rejects an assessee's books and levies a flat rate the amount of the rate is in his discretion and is not a matter which can be referred to the High Court. It shows further that the mere fact that the rate is very high is not in itself a ground for a reference or for setting the assessment aside; that in the absence of anything to the contrary it must be assumed that the Income Tax authorities used their discretion reasonably and not arbitrarily and that their appraisal of the value was based on experience; and that the basis of flat rate is the previous practice and experience of the Department in similar matters.

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PART XIII.

NOTES & COMMENTS.

Three Notable Judgments.

Three judgments having an important bearing on the development of income-tax law are reported in this number. The first judgment to which we would refer is that of the Allahabad High Court in *Major A. U. John's Case* [1938 I.T.R. 434], which defines the meaning of income and distinguishes income from casual and non-recurring receipts not arising from business. Then there is the decision of the Bombay High Court in the case of the *Bombay Grain Merchants' Association* [1938 I.T.R. 427] which decides that an association which has for its object the promotion of the interests of a section of the public alone, e.g., persons interested in commerce, as distinguished from the general public, cannot claim exemption from tax under Section 4 (3) (i) and (ii), and the third is the important judgment pronounced by the Bombay High Court in the case of the *Bombay Trust Corporation* [1938 I.T.R. 445] which lays down that the income-tax authorities have no power to call for the production of account books which are not in law in the possession or control of the assessee, and to levy summary assessment under Section 23 (4) on non-production of such accounts. The last case is sure to be read with much interest by assesseees who are treated as agents of non-residents and called upon to produce the accounts of the latter.

Major John's Case.

In *Major A. U. John's Case* (1938 I.T.R. 434) a Special Bench of the Allahabad High Court has considered in some detail the true meaning of 'income' as used in the Indian Income Tax Act, and laid down that the element of periodical receipt or regularity or expected regularity of monetary return is an essential ingredient of 'income'.

DEFINITION OF INCOME IN SHAW WALLACE & Co's CASE.

The classical observations of the Judicial Committee in *Shaw Wallace & Co.'s Case* on the true import of income, which deserve to be quoted again and again, run as follows :

"The object of the Indian Act is to tax 'income', a term which it does not define. It is expanded, no doubt, into 'income profits and gains' but the expansion is more a matter of words than of substance. 'Income', their Lordships think in this Act connotes a periodical monetary return 'coming in' with some sort of regularity or expected regularity from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall". Similarly, with regard to 'business' they say: "By Section 2 (4) business 'includes any trade, commerce or manufacture.' The words used are no doubt wide but underlying each of them is the fundamental idea of the continuous exercise of an activity".

It is obvious that in their Lordships' view the element of periodical return coming in with some sort of regularity or expected regularity is one of the essential elements of income—the characteristic which distinguishes it from a casual and non-recurring receipt in the nature of a windfall.

GAYA PRASAD'S CASE.

In *Gaya Prasad and Chotey Lal, In re* [1935 I.T.R. 177] a Bench of the Allahabad High Court took the view that the observations of the Privy Council quoted above should be taken in conjunction with the facts of that case and that the Board did not intend to lay down any general principle that periodical receipt or regularity of return is an essential element of income.

In that case the assessee, who did not carry on any business and whose income (apart from the receipt in question) was from property alone, advanced money for conducting a litigation on condition that he was paid a fixed sum in addition to the money advanced if the borrower succeeded. He got the stipulated amount and their Lordships held that the amount was 'income' and not a casual and non-recurring receipt not arising out of business.

OUR COMMENTS ON GAYA PRASAD'S CASE.

In commenting upon this case in the year 1935 we said :

"With all respect to their Lordships the receipt in question cannot be said to be income from a business carried on by the

assessee. Their Lordships of the Privy Council have clearly pointed out that business connotes continuity and regularity of transactions. If the principle laid down in the Allahabad case is to be applied, income from lotteries would be taxable, profit gained by an isolated transaction of purchase and sale of property would be taxable. Their Lordships appear to have been carried away by the notion that 'any receipts exceeding capital must be treated as profit'. That there may be accretion to capital which is not of the nature of income has been ignored. We think the receipt in question is not income in the true sense of the word, much less income from 'business'". (Vide 1935 I.T.R. Notes and Comments pp. 25-26)

GAYA PRASAD'S CASE DISSENTED FROM IN MAJOR
JOHN'S CASE.

We are much gratified to find that *Major John's Case* case was referred to a larger Bench in view of the decision in *Gaya Prasad's Case* and that the Special Bench have dissented from the interpretation which was placed in *Gaya Prasad's Case* on the word 'income' and on the observations of the Judicial Committee in *Shaw Wallace & Co's Case*. Referring to *Gaya Prasad's Case* their Lordships said in *Major John's Case* (1938 I. T. R. at pp. 443-444) :

"In *Gaya Prasad and Chotey Lal, In re*, a Bench of this Court, however took the view that the observations of the Privy Council above quoted should be taken in conjunction with the facts of the particular case and that the Board did not intend to lay down any general principle. We are unable to agree with this view of their Lordships' observations. In our opinion, the intention of the Board was to enunciate a working definition of income for the guidance of the Courts in India."

Again their Lordships said (1938 I.T.R. at p. 443) :

"It is apparent to us that in making the above observations the Board had in view the various relevant sections of the Act, and that the Board's intention was to lay down for the guidance of the Courts in India some general principle on the question as to what can be treated as income under the Act. The terms of that part of their Lordships' judgment are undoubtedly general and, in our opinion, were not confined to the particular facts and circumstances of the case which their Lordships were considering. It appears to us that their Lordships intended to indicate that the

element of periodical receipt or regularity or expected regularity of monetary return is an essential ingredient*of income under the Indian Income Tax Act."

The observations of the Judicial Committee in *Shaw Wallace & Co.'s Case*, which are by themselves very clear, taken with this Special Bench decision in *Major John's Case* should, we think, place beyond doubt the principle that 'the element of periodical receipt or regularity or expected regularity of monetary return is an essential ingredient of income under the Indian Income Tax Act, and that, similarly, 'business' connotes the fundamental idea of the 'continuous exercise of an activity'.

Recent decisions under the Income Tax Act with the exception of *Gaya Prasad's Case* support the view expressed in *Major John's Case*, e.g., *In re Mothey Ganga Raju* (1935 I.T.R. 58), *In re Milne* (1934 I.T.R. 25). In both these cases the receipts in question were held to be casual and non-recurring receipts not arising out of business and as such not assessable to income-tax.

'Charitable Purposes': Bombay Grain Merchants' Association Case.

Though we are not now prepared to say that on the facts of the case the recent decision of the Bombay High Court in the case of the *Bombay Grain Merchant's Association* [reported at p. 427 *infra*] was not correctly decided, we think the broad statement made in that case that an object of general public utility means an object of public utility which is available to the general public as distinct from any section of the public and that works of public utility confined to a section of the public, e.g., those interested in commerce, would not be objects of general public utility, must be read and applied with great caution. An object may be confined to persons living within a specified local area, or belonging to a particular religion, or to a particular sex, or within a particular age (e.g., children or the old) or having a particular disability (e.g., leprosy or blindness), or belonging to a particular profession. An object, we think, will not cease to be an object of general public utility merely because it is confined to such a section of the public. The learned Chief Justice has evidently read the word 'general' as qualifying the word 'public', but we think it qualifies the word 'utility'. There are numerous English decisions defining the scope of the word 'charity' and 'public or general utility'. None of them supports the statement above referred to. These cases are considered in *In re The Tribune*.

In that case JAI LAL, J., said (1936 I.T.R. at p. 253) :

'From what I have stated above it would be observed that charitable purposes and objects of general public utility embrace a wide range and that it is not necessary that such objects should directly benefit the entire community, but it is quite sufficient if a substantial portion of the community benefits therefrom.'

Referring to *Pemsel's case* [1891 A.C. 531] his Lordship observed (see 1936 I.T.R. at p. 254) 'if the donor considers a particular purpose beneficial for the *recipient public, which includes a section of the public*, then the purpose must be held to be charitable etc.'

And TEKCHAND, J., said at p. 273 :

'It is common ground that it is not necessary that the object should be to benefit the whole of the mankind or all the persons living in a particular country or province. *It is sufficient if the intention is to benefit a sufficiently large section of the community, as distinguished from specified individuals*'.

Though there was a difference of opinion in the *Tribune case*, as TEKCHAND, J., observes there was no difference of opinion on this point. 'It was common ground'.

The distinction which has to be noted is that between the public and specified individuals, not that between the general public and a section of it.

The decision in *Grain Merchants' Association case* can perhaps be supported on the ground that the object was not one of '*public utility*' or '*charitable*' in the sense in which that term is understood, but not on the ground that the benefit was confined to a section of the public only.

This case raises the interesting question whether an association can escape income tax by merely stating in general terms in its constitution that its funds are to be spent 'for objects of general public utility' without specifying what those objects are. If the exemption under Section 4 (3) (i) and (ii) can be claimed by inserting such a general clause in the objects, income tax can very easily be evaded. We think it can be forcibly argued that there will be no valid trust unless the objects are specified more definitely and there is ample authority in the law of trusts to support this view.

Bombay Trust Corporation's Case.

The third case is *Commissioner of Income Tax, Bombay v. The Bombay Trust Corporation* [reported below at page 445] in which the Bombay Trust Corporation, which had been carrying on a long

and strenuous fight with the Bombay Income Tax Department has at last come out successful. By an intelligent and clever alteration of the legal nature of its connection with the Hongkong Trust Corporation by forming a company to act as intermediary banker and by refusing to produce or cause to be produced the accounts of the Hongkong Corporation it has saved itself from an income tax of Rs. 3 lacs. The legal importance of the present decision lies in this that this judgment establishes that a resident cannot be called upon to produce the accounts of a non-resident, however closely and intimately in common parlance it may be said to be connected with the latter, if, in the eye of the law, the books are not in the control or possession of the former. As Mr. Justice KANIA has put it 'the utmost that can be stated on the allegations or statements found in the reference, is that the two companies may be called friendly. There appears, however, no justification in law, on that account, to call upon one friend to produce the books of another and in default to make the party called upon liable under Section 23 (4)'. It seems to be a hard case for the Department on the facts, but, as the *Law Journal of England* said in connection with *Sir David Yule's Case* [1936 I.T.R. 239] no tears are shed when the Income Tax Department sustains a big failure.

Chief Justice's Suggestions for Amending the Act to Prevent Abuse of Authority.

The Chief Justice of Bombay has made some observations in this case with regard to the necessity of amending the Act in certain respects to prevent an abuse of authority, which deserve to be brought to the notice of the Legislature. As the law stands there appears to be no means of compelling the Income Tax Commissioner to refund tax illegally levied, though Section 66 (7) lays down that amounts overpaid shall be refunded. The Legislature, his Lordship says, should consider the desirability of protecting the tax payer from abuse of authority in the matter of refund of tax illegally levied. The strong remarks made by the Judicial Committee and the High Court of Bombay in this case on the refusal of the department to refund a tax of Rs. 3 lacs which they ought to have refunded in 1933 should at once open the eyes of the Legislature to the necessity of prescribing some procedure by which the High Court may compel the department to make a refund where the department refuses to do so. The amendment proposed to be made in Section 66 (7) by clause 75 of the new Bill does not make any such provision but on the other hand is intended

to empower the High Court to make an order allowing the Commissioner to retain tax overpaid pending an appeal to the Privy Council.

Interpretation of Taxing Statutes.

The *Canadian Bar Review* (Jan., 1938) contains a very learned and instructive article on the Interpretation of Statutes by PROFESSOR JOHN WILLIS of America. Dealing with the interpretation of taxing statutes the learned Professor states as follows:—

PRESUMPTIONS RELEVANT TO TAXING ACTS.

“The last important class of modern Acts to which the courts have a special approach is that of Taxing Acts. As much social reform has been, and is still being effected, by the use of the taxing power, as by openly reformatory measures. Lloyd George's famous budget of 1909 started the movement which for better or for worse has completely changed the English social scene: the purpose of the Canadian Tariff in taxing the importation of goods manufactured abroad is not so much to raise a revenue as to encourage the growth of “infant industries” in Canada: the heavy taxation of liquor in both England and Canada is expressly designed to discourage drinking. This was not always so. Traditionally, and hence in the eyes of the common law, first Kings and then legislatures taxed the masses in order to benefit a few court favourites; the judges therefore leaned against taxing Acts. As long as the purpose of taxing Acts was merely to raise money for the general purposes of government, the judges held to their attitude: since a taxing Act had no particular “object” their final resort had to be some presumption. Today legislatures do often tax with social objects. What effect have these changes had upon the attitude of the courts towards taxing Acts?

STRICT CONSTRUCTION.—Once upon a time taxing Acts, like penal acts, were construed as narrowly as possible. Today it is undoubted law that they are to be construed in just the same way as any other Act: [See *Manning's Rating and Assessment*, pp. 16-21 where the whole matter is discussed]. The cases are, no doubt, agreed that the benefit of the doubt still goes to the subject and not the Crown; but the fact that a recent Canadian case found it necessary to collect from previous cases no less than three different reasons why this was so, does seem to indicate that the presumption in favour of the subject is felt to rest on no solid ground and that it will tend to disappear: [*R. v. Crabbs*, 1934, 4 Dom. L. R. 324]. Indeed, within the last six years the English courts

have in one case rejected the presumption in favour of the subject and adopted instead the "mischief rule" * [*Powell Lane & Co. v. Putnam* (1931, 2 K. B. 305)]; in another they have gone so far as to discover in the English Income Tax Acts what they call "the scheme of the legislation": [*Astor v. Perry* (1935 A. C. 398)].

EVASION.

With regard to 'evasion' the article continues:

"The attitude of the courts towards tax evasion is rather remarkable. The House of Lords has solemnly ruled it not only legal but moral to dodge the Inland Revenue: [*Inland Revenue Commissioners v. Levene* (1928 A. C. 217 at p. 227 per Lord Sumner)]. Time and again courts have decided that Acts should not be construed so as to permit evasion of them, but by a series of sophistries about the words "evasion" they have succeeded in satisfying themselves that evasion of a taxing statute is not "evasion" at all, but is "keeping within the permissible limits". The results of this curious attitude were until recently thought to be mitigated by a rule that the question whether the financial arrangements of a tax payer fell outside the Act or not was to be determined by looking not at the precise legal effect but at the substance of those arrangements. In 1936, however, the House of Lords rejected the "substance doctrine" in no uncertain terms and permitted the Duke of Westminster to deduct from his taxable income as an annuity an annual payment made to a servant as wages, merely because the Duke's solicitor had been clever enough to draw up a deed under which the Duke bound himself in law to pay the servant, irrespective of service rendered, an annual sum which neither party ever intended to be in fact anything but a remuneration for services rendered: [*Inland Revenue Commissioners v. Duke of Westminster* (1936 A. C. 1)].

The conclusion seems to be that the attitude of the courts towards taxing Acts is at present uncertain; but in spite of an occasional "liberal" decision, the general tendency is still to "give the tax-payer the breaks" by ignoring the "object" of the Act, if any, in favour of the old restrictive approach."

*[The 'mischief rule' referred to above is the rule laid down in *Heydon's Case* that it is the duty of the Courts to consider what mischief the Act was intended to remedy and to construe the Act in such a way as to suppress that mischief and advance the remedy—Ed].

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PART XIV.

NOTES & COMMENTS.

CONVERSION OF HINDU UNDIVIDED FAMILY INTO FIRM.

JUGAL KISHORE MUKAT LAL'S CASE (1938 I. T. R. 494).

The public are sure to read with great relief the decision of the Allahabad High Court in *Jugal Kishore Mukat Lal, In re*, (decided on the 8th May and reported at p. 494 below). The well-considered judgment delivered by COLLISTER and BAJPAL, JJ., in this case puts on the right track the most unsatisfactory state of the decisions on the subject of conversion of Hindu undivided families into firms. We have dwelt upon this topic on previous occasions. Reference may be made in particular to pp. 6-7 of our Notes & Comments in the current volume of the Income Tax Reports.

CONFUSED STATE OF THE LAW.

The Madras High Court held in *Thontepu Chinna Pullayya's Case* (1937 I.T.R. 132) that when the members of a Hindu undivided family separate and form themselves into a firm, and the firm consists exclusively of the members of the previous family there is no succession within the meaning of Section 26 (2) and assessment should be made under Section 25-A. In a series of cases, some of which are Full Bench decisions, the Lahore High Court refused to accept this view. They held that Sec. 25-A applies only to cases of mere disruption of Hindu families. Where the members subsequently form themselves into a firm and continue the business, Section 26 (2) would come into operation and the firm should be assessed as such. They further held that the fact that the business was continued by all the members of the family and not by some of them, alone or with strangers, would not make Section 26 (2) inapplicable. Vide: *Beliram Bros. v. Commissioner of Income Tax, Punjab* (1935 I.T.R. 243), *Mittar Chand Lakhmi Das' Case* (1937 I.T.R. 127: I.L.R. 1937 Lah. 189), *Ram Rakha Mal's Case* (1937 I.T.R. 325: I.L.R. 1937 Lah. 325). Referring to the Madras Case they said: 'With all respect we are not prepared

to endorse this opinion'. The authority of the Lahore Cases would thus have drowned the Madras Case. But in *Jesinghbhai Ugarchand's Case* (1938 I.T.R. 25) the learned Judges of the Bombay High Court, under an unfortunate misapprehension that the Madras Case was the only decision on the point, followed that case 'with a view to prevent conflict of decisions and without expressing any opinion of their own'.

THE ALLAHABAD VIEW.

In *Jugal Kishore Mukat Lal's Case* the Allahabad High Court, after considering the question carefully, have come to the conclusion that "Section 25-A applies only where there has been a partition among the members of the undivided family and nothing more. Section 26 would apply where a firm has been newly constituted and it does not matter whether this firm owes its origin to certain individuals, strangers to each other, entering into a contractual relationship and agreeing to constitute a firm, or whether it owes its origin to a joint family whose members have divided amongst themselves and who have then entered into an agreement to constitute themselves into a firm. In either case, where at the time of making an assessment a firm has come into existence the assessment must proceed on the basis of Section 26."

Their Lordships, referring to the Lahore cases, said that they are in complete agreement with the view entertained by that High Court, namely, that "Section 25-A applies only to those cases where the question involved is one of pure and simple disruption of a Hindu undivided family unattended by conversion or transformation into a new entity, and that Section 26 is intended to meet completely those cases which are specified in sub-sections (1) and (2) thereof respectively, *in whatever way the situation envisaged there may arise*".

We hope the Madras and Bombay High Courts will reconsider the views expressed in *Thontepu Chinna Pullayya's Case* and *Jesinghbhai Ugarchand's Case* respectively, in view of the strong dissent expressed in the four well-considered decisions of the Lahore and Allahabad High Courts referred to above.

A SMALL ERROR.

An obvious slip, which however does not detract from the value of the conclusion, has crept in the judgment in *Jugal Kishore Mukat Lal's Case*. "Under Section 2 clause (9)" their

Lordships say, "‘person’ includes a Hindu undivided family, but it does not include a firm".

If the expression ‘person’ does not include a ‘firm’ it is difficult to see how Section 26 (2) can come into operation at all for Section 26 (2) distinctly refers to cases where a ‘person carrying on business’, profession or vocation has been succeeded in such capacity *by another person*, and again says ‘assessment shall be made *on such person* succeeding’. The fact that Section 2 (9) says ‘person includes a Hindu undivided family’ does not lead to the inference that it does not include a firm.

Obviously ‘person’ is used in Section 26 (2) in a very wide sense including all the units mentioned in Section 3 which can be assessed, *viz.*, individuals, Hindu undivided families, companies, firms and other associations of individuals. The fact that the term ‘assessee’ is defined in Section 2 (9) as a *person* by whom income tax is payable makes this point clear.

Allowance in Respect of Animals Which Have Died or Become Permanently Useless.

Section 10 (2) (vii-a) of the Indian Income Tax Act provides for an allowance ‘in respect of animals which have been used for the purposes of the business otherwise than as stock in trade and have died or become permanently useless for such purposes.’ The short question whether such allowance could be granted when cattle are sold by the owner of a dairy farm after closing down the business, was raised in a recent case before the Allahabad High Court, *In re Ganeshi Lal Bhattawala* (decided on 5th May and reported at p. 489 *infra*). A dairy business owned by the assessee was closed down in 1930, the live stock left over were sold in 1932 and in the assessment for the year 1933-34 the assessee claimed deduction of the loss incurred by the sale. Their Lordships, agreeing with the Commissioner, held that the allowance could not be given inasmuch as the animals were sold, not on account of their having become permanently useless, but because the business had been closed down, and also because the business in respect of which the deduction was claimed had been discontinued before the year of account. The words ‘for the purposes of the business,’ their Lordships said, are referable to the business in respect to which a return has been called for and submitted. From a tax point of view it is better, therefore, to sell the stock before closing down the business.

Bad Debts: Importance of Entries Relating to Interest on Bad Debts.

The decision of the Patna High Court in *Sheosahayamal Hiralal's Case* (reported at p. 485 infra) should draw attention of assesseees to a small point which should be remembered in keeping accounts relating to bad debts. If the accounts are kept in the mercantile system and interest is not debited against the debtor and returned as income in a particular year it would be difficult to claim the debts as a bad debt in any subsequent year. Omission to include interest in the return for any year would be a circumstance from which the income tax authorities could come to the conclusion that the debt had become bad before that year. On the other hand, if the assessee had been assessed to income tax in any year on interest from a debt they could not take up the inconsistent position that the debt had become bad before that year. In their order directing the Commissioner to refer the case, their Lordships said :

‘In order to see whether the debt was in law extinguished on this date it is necessary to call upon the Commissioner to state whether in fact in respect of this debt the assessee has been assessed to income-tax in respect of the accrual of interest on this debt it being not clear how the debt can be treated as having been wiped off in 1930 if interest is to be treated as having accrued since that date on the debt.’

The decision of the same High Court in *Hanutram Bhuramal, v. Commissioner of Income tax, Bihar & Orissa* [1938 I.T.R. 290] lays stress on the same point. In this case, where a debt had been brought forward from year to year as an asset bearing interest and income-tax had been charged on it in respect of the years previous to the assessment year in question it was held that it was not open to the department to hold that the debt had become bad before the assessment year.

In the light of these decisions assesseees should, we think be careful in including in, or omitting from, their returns interest on debts which are doubtful or bad.

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PART XV.

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**The Judicial Committee on Income From Foreign Exchange Business:
Chunilal Mehta's Case [1938 I.T.R. 521].**

The decision of the Bombay High Court in *Commissioner of Income Tax, Bombay v. Chunilal B. Mehta* [1935 I.T.R. 367] has been affirmed by the Judicial Committee, and as the law now stands, a person resident in British India carrying on business here and controlling transactions abroad in the course of such business is not by these mere facts liable to be taxed on the profits on such transactions. If the profits of the transactions have not been received in or brought into British India, the fact that the profits depend on the exercise of judgment and skill by the assessee from British India and the giving of directions from British India will not render them liable to be taxed in British India. Under the Indian Act the test of chargeability is whether the profits accrue or arise within British India or are deemed by the Act to accrue or arise there. The place where the business is carried on, or the source of the profits is situated, is not the determining factor.

This decision would have been of very great importance to assesseees but for the fact that the Income Tax Enquiry Committee have specially recommended that provision must be made to bring such foreign income within the ambit of the Indian Income Tax Act and the Bill recently introduced contains such a provision: [See The Income Tax Enquiry Report, Chapter I, Section 1 p. 2]. The Note on the Income Tax Amendment Bill, clause 4, says: "The Bill enlarges the scope of the section [Section 4] by including (1) the whole of the foreign income of a person resident and domiciled in British India whether brought into British India or not (2) the whole of the foreign income from business, profession or vocation of a person resident but not domiciled in British India whether brought into British India or not."

Where Business Profits Accrue.

Though the actual decision of the Privy Council in *O. B. Mehta's Case* may thus cease to be of importance after the enactment of the Income Tax Amendment Bill, there are some very valuable statements in the judgment of the Judicial Committee on the scope of Sections 4, 6 & 10 of the Indian Income Tax Act and on the general principles relating to the place where business profits accrue or arise. The main contention before the Board in this case was that the profits of the assessee's 'foreign' transactions were but part of the profits of his Bombay business which must be computed as a whole, all profits and all losses having their effect upon the final figure. It was argued that the principle to be applied in the case of business profits is that loss or profit is the result of the trade as a whole, that the source of the profits is the business as a business, and that the ultimate and total profit of the business must be regarded as accruing or arising at the place of direction or control. Their Lordships said that the Indian Income Tax Act is not capable of this construction. Regarding the argument based on Section 4 & 6 that the respondent's business is the source of the profits and that these sections require that the situation of the source should determine the place where the profits arise, they said that in their Lordships' view this was straining of the sections. Section 6 is only intended to describe the different kinds of profits and if the condition "accruing, arising or received in British India etc." is satisfied by the profits they will not escape by reason of any quality or circumstance of the source. To answer the question "Do these profits accrue or arise in British India?" by asking another "What in the sense of Section 6 is the source of these profits and is it situated in British India?" is to divert attention from that to which the statute points and to devote attention to what it discards. The profits of each particular business are to be computed wherever and whomsoever the business is carried on but only on condition that they are profits 'accruing, arising or received in British India etc'. What connection exists, if any, between the place of direction and the place at which the profits arise is a matter not touched by Section 4, 6 or 10. They do not even make any mention of the place at which the business is carried on. In these circumstances, their Lordships say, it cannot be held that it is itself the test of chargeability, by virtue of a rule, not mentioned either, that profits arise or accrue at the place where the business is carried on.

With regard to the argument based upon general principles, apart from Sections 4, 6 and 10 of the Act, their Lordships say that there is no necessity arising out of the general conception of a business as an organisation that profits should arise only at one place. In their Lordships' opinion the high doctrine that profit in the case of a business must be taken so strictly that it is not to be understood distributively at all, cannot be read into the Indian statute without violence not only to its language but to its scheme. Profits are frequently, if not ordinarily, regarded as arising from many transactions each of which has a result—not as if the profits need to be disintegrated with difficulty, but as if they were an aggregate of the particular results. The discrimination between all kinds of profits according to the place at which they accrue or arise is, their Lordships say, a plain dictate of the Indian statute.

Zarpeshgi Tika Leases.

Raja Dhakeshwar Prasad Narain Singh's Case (1938 I.T.R. p. 476) decides an important question relating to *Zarpeshgi Tika Leases*. Under this kind of transaction the mortgagor borrows a certain sum of money and grants a lease of the mortgaged properties to the mortgagee for a certain number of years. Interest on the mortgage amount is calculated at a certain rate and the period of the lease is so fixed that the whole amount of principal and interest may be wiped off by appropriation of the rents and profits. The question arises in such cases whether the mortgagor is entitled to claim any deduction in respect of the interest which has been taken into calculation in fixing the period and which in fact is received by the mortgagee in the shape of rents and profits. In this case the mortgagor purchased a decree bearing interest at 6 per cent and for the price of Rs. 30,000 executed a *Zarpeshgi tika lease* for 17 years to the vendor and claimed that interest on the *Zarpeshgi* amount which had been calculated in fixing the period at 17 years should be set off against the interest of 6 per cent on the mortgage decree which accrued due to him. The High Court held, agreeing with the Commissioner, that there was no liability on the mortgagor to pay interest and no payment of interest in fact. A rate of interest had only been taken as a basis for fixing the period. They said this was a case where the assessee had purchased an asset producing taxable income in exchange for an asset producing non-taxable income and that the claim for interest was not allowable under Section 10 (2) (ix) or Sec. 12 (2).

Income From Dairy, Whether Agricultural Income.

The interesting question whether income from a dairy is agricultural income or income from trade, was considered recently by the Rangoon High Court in the case of the *Kokine Dairy* (1938 I.T.R. 201) and the learned Chief Justice (with whom DUNKLEY, J., and SPARGO, J., agreed) has laid down the principle to be applied to such cases in these words:

"What is exempted from tax by the Income tax Act is agricultural income and for the purpose of considering the position of a dairy farm and the milk which is derived from it, it is necessary to enquire whether the cattle are kept in an urban area and stall-fed or whether they are pastured upon the land. If they are kept in an urban area and stall-fed, then the business of keeping them could, in my opinion, scarcely be considered agricultural and must be considered as trade."

Continuing, his Lordship said:

"In my opinion the question must be a question of degree and therefore a question of fact. Where cattle are wholly stall-fed and not pastured upon the land at all, doubtless it is trade and no agricultural operation is being carried on: where cattle are being exclusively or mainly pastured and are nonetheless fed with small amounts of oil-cake or the like, it may well be that the income derived from the sale of their milk is agricultural income. But between the two extremes there must be a number of varying degrees, and the task for the Income tax Officer is to apply his mind to the two distinctions and to decide in any particular case on which side of the fence, if I may use the term, the matter falls."

The task of the income tax authorities in such cases is really a difficult one. Cattle are rarely wholly stall-fed or wholly maintained on pasture land. And even where cattle are kept in an urban area, the owner might own or have taken on lease large areas of adjoining pasture land for grazing the cattle. Matters may become even more complicated where the cattle are kept in rural areas but a trade in milk, butter and other dairy products is carried on in an urban area.

The real point to which we should direct our attention in such cases is whether on all the facts and circumstances appearing in each case the income in question is 'in pith and substance' the product of some land or the product of a trade; and we think further that if the trade portion of the operations are separable from the agricultural operations the income tax authorities would be justified in treating the profits from each separately.

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PART XVI.

NOTES & COMMENTS.

Appearance of Commissioner's Counsel in Mandamus Applications.

The observations made by SHARPE, J., in the *Kokine Diary Case* (1938 I.T.R. 145) on the failure of the Commissioner to instruct his counsel to appear in an application under Section 66 (3) have been criticised in the final judgment delivered in that case, (1938 I.T.R. 521). The Chief Justice said: "I do not accept the view put forward by my learned brother SHARPE, J., that the Advocate-General should always attend in these cases". And DUNKLEY, J., observed: "As regards the appearance of the learned Advocate-General in applications under Section 66 (3) of the Income Tax Act, to this Court for a mandamus, in my own view it would be wrong to require his appearance in the first instance, because most of these applications plainly do not raise any questions of law and they can be dismissed *in limine* without hearing the learned Advocate-General on behalf of the Commissioner of Income Tax. If after hearing the applicant, the Bench considers that the case for the Commissioner of Income Tax should be placed before them at that stage, then it is simple to adjourn the case in order to obtain the appearance of the learned Advocate General for the Commissioner of Income Tax. That is the practice which, in my opinion, should be adopted in such applications".

The High Court may, of course, dismiss an application under Section 66 (3) *in limine* before issuing notice to the Commissioner to show cause why he should not be required to state the case. But if the High Court issues notice to the Commissioner the Commissioner will be acting properly and wisely in instructing his counsel to appear without waiting for a further adjournment. SHARPE, J.'s observations relate only to the second

stage, that is, after notice has been issued to the Commissioner and, applied to that stage, they seem to be fully justified. There would be no inconsistency between the view of DUNKLEY, J., and that of SHARPE, J., if the difference between the two stages is kept in mind, and unless the High Courts keep these two stages distinct it would be difficult for Commissioners to decide whether they should instruct their Counsel to appear or not. The proper procedure is obviously to dismiss such applications as are simple and do not clearly raise any question of law *before notice is issued to the Commissioner* and to issue notice only on applications on which the High Court wishes to hear the Commissioner.

Receipts from Betting Transactions of Professional Player.

An interesting instance of receipts from betting transactions connected with an employment or business but not arising out of it is afforded by the case of *Down v. Compston* (21 Tax Cases 60 ; 53 T.L.R. 545). The assessee was a professional golfer attached to a golf club. He habitually engaged in private games of golf on handicap terms principally with and against amateurs, for bets of varying amounts and won substantial sums for a period of ten years, and the question arose whether these winnings were profits or earnings arising out of a profession or vocation. The Commissioners were of opinion that the receipts were not annual profits or gains within the meaning of the Income Tax Acts but mere winnings from betting transactions and their decision was upheld by the High Court. LAWRENCE, J., held that the winnings did not arise from his employment or vocation and that they were in no way analogous to gratuities for services rendered. There was also no organisation in the case to justify the view that the assessee was carrying on a business of betting on these private games of golf.

Deduction of Expenditure Incurred to Earn Tax Free Profits.

The decision of the Court of Appeal of England in *Hughes (Inspector of Taxes) v. Bank of New Zealand* [1937, 1 K.B. 419 ; 106 L.J.K.B. 309 ; 156 L.T. 153 ; 1936 A.E.R. 125] deserves to be more widely known in India than it is. The excellent judgment delivered by Lord Wright in this case (with which Lord Justice Romer and Lord Justice Greene concurred) will always be read by those who are interested in the law of income tax with great pleasure and delight. The case is reported at p. 541 below.

The points decided are (1) that interest on War Loans, on India Government stock and on Colonial securities is absolutely exempt from income tax, the first under Section 46 of the English Income Tax Act, the second under Rule 2 (d) of the General Rules applicable to Schedule C, and the third under Rule 7 of the Miscellaneous Rules under Schedule D; (2) that such interest cannot be taxed as trading profits or gains of a business; and (3) that though such interest is exempt from taxation, the owner of the securities is entitled in claiming allowances to include in his trading expenses, the expenses incurred in earning such interest. The last proposition may seem to be a little anomalous, but as the noble lords have observed, there is no provision in the Acts for apportionment of business expenses. Several points of general importance relating to income tax are considered in the judgment and we would advise our readers to go through the judgment carefully.

Impartible Estates.

The decision of the Madras High Court in *Raja of Bobbili's Case* [1937 I.T.R. 78] in which it was held that the income of an impartible estate must be assessed in the hands of the holder of the estate for the time being as his individual income and not as the income of a Hindu undivided family has been recently followed by the Patna High Court in the *Raja of Kanika's Case* reported at p. 536 below. We may however observe that the Privy Council have left the question open in the concluding portion of their judgment in *Kalyanji Vithaldas's Case* [1937 I.T.R. 90].

Though there is much to be said against it, the weight of authority in India is now so strongly in favour of the view above propounded that it is perhaps unlikely that the Privy Council would take a different view.

Notification Under Sec. 60 of the Indian Income Tax Act.

The following Notification under Sec 60 of the Indian Income Tax Act has been published in the *Gazette of India* dated August 13, Part I, p. 1374:—

No. 7.—In exercise of the powers conferred by Section 60 of the Indian Income tax Act, 1922 (XI of 1922), the Central Government is pleased to direct that the following further amendment

shall be made in the Notification of the Government of India in the Finance Department No. 878-F., dated the 21st March 1922 namely :—

In paragraph (a) of the said Notification after clause (10-F) the following clause shall be inserted, namely :—

“(10-G) the salary of the Trade Commissioner for Ceylon in India and of any members of his staff who are citizens of Ceylon and have been detailed for duty with the said Trade Commissioner by the Ceylon Government”.

Changes in the Pay and Cadre of Income Tax Service.

The following notification of amendments made in the Pay and Cadre Schedules relating to Income Tax service is published in the *Gazette of India* dated 23rd July 1938, Part I, p. 1288 :

No. F. 9 (2) Ex. I/38 P. & C. S. No. 27.—In exercise of the powers conferred by Section 241 of the Government of India Act, 1935, the Governor General in Council is pleased to direct that the following further amendments shall be made in the Pay and Cadre schedules of Central Services annexed to the rule published with the notification of the Government of India in the Finance Department. No. E. 22 (1)—Ex. I 35, dated the 1st March 1935, namely :—

In Chapter XIII of the said Schedule—

1. Under the head “*Central Service, Class I—Income tax Service (Class I)*”, in the table relating to “*I—Commissioners of Income tax*”, in the column headed “strength”.—

(i) for the entry “For deputation to Burma.....I”, the entry “Posts for leave reserve.....” shall be substituted ; and

(ii) for the figure “7”, the figure “6” shall be substituted.

II. For the table relating to “*Central Service, Class II, Bengal Income tax Service*”, the following table shall be substituted, namely :—

Strength.		Monthly rates of pay in successive stages of 12 months' service.	Posts carrying special pay in addition to pay on time-scale.
Posts for duty	36 *		
Total	36		
Number and character of posts.		Stages	Pay
			Special pay per mensem.
Income Tax Offi- cers.	36	1	Rs. 500
		2	500
		3	550
		4	550
		5	600
		6	600
		7	650
		8	650
		9	700
		10	700
		11	750
		12	750
		Efficiency bar	
		13	800
		14	800
		15	850
		16	850
		17 and over	900
* Additional Income tax Officers.	16	1	300
		2	300
		3	350
		4	350
		5	400
		6	400
		7	450
		8	450
		9	500
		10	500
		Efficiency bar	
		11	550
		12	550
		13	600
		14	600
		15	650
		16	650
		17	700
		18	700
		19	750
		20	750
		Efficiency bar	
		21	800
		22	800
		23	850
		24	850
		25 and over	900

Income tax Rs.
Officers, 150
Companies
Districts.
Nos. I and II.

* These posts are supernumerary consequent on a re-organisation of the department and will be abolished as vacancies occur."

III. In the table relating to "*Central Service, Class II.—United Provinces Income-tax Service*"—

(i) in the column headed "Number and character of posts" for the entry "Assistant Income tax Officers.....2" the entry "Assistant Income tax Officer.....1" shall be substituted; and

(ii) in the Note appended to the said table, for the figure and words "2 posts of Assistant Income tax Officers" the figure and words "1 post of Assistant Income tax Officer" shall be substituted.

IV. In the table relating to "*Central Service, Class II.—Punjab, North West Frontier and Delhi Provinces Income tax Service*"—

(i) in columns 2 and 3, the entry "Efficiency bar" where it occurs for the first time shall be marked with a dagger; (†)

(ii) in column 1, the entry "Income tax Officers.....37" shall be omitted; and

(iii) Note 2 of the Notes appended to the said table shall be renumbered as Note 3 and before that Note as so renumbered, the following Note shall be inserted, namely:—

"(†) Note 2.—When all the officers who were on the scale of Assistant Income tax Officers prior to the 1st October 1936 have crossed the Rs. 350 stage, this efficiency bar shall be dispensed with."

Draft Amendment to Income Tax Rules : re Refund of Tax Under India and Burma (Income-tax Relief) Order, 1936.

The following draft of a further amendment to the Indian Income-tax Rules, 1922, which the Central Board of Revenue proposes to make in exercise of the powers conferred by sub-section (1) of Section 59 of the Indian Income-tax Act, 1922 (XI of 1922), read with paragraph 5 of Part II of the India and Burma (Income-tax Relief), Order, 1936, is published as required by sub-section (4) of the said section for the information of all persons likely to be affected thereby, and notice is given that the said draft will be taken into consideration on or after the 15th October 1938.

Any objection or suggestion which may be received from any person in respect of the draft before the date specified will be considered by the said Board. [Vide *Gazette of India* dated 20th August Part I, p. 1399].

DRAFT AMENDMENT.

After rule 40 of the said Rules, the following rules shall be inserted, namely:—

"40-A. An Application for refund of income-tax under the India and Burma (Income-tax Relief) Order, 1936, shall be made in the following form:—

Application for relief from double/triple income tax under the India and Burma (Income tax Relief) Order, 1936.

I _____ of _____, do hereby
state that I have paid (1) Burma Income-tax/income tax
Burma Income-tax/income tax
and super-tax amounting to _____
and super-tax and United Kingdom income-tax/income-tax
Rs. _____

and super-tax amounting to Rs. _____ and £ _____ respectively

for the year ending 31st March 19 _____ on an
ended

income (2) of Rs. _____ and £ _____ respectively and
Rs.

that Indian income-tax/income-tax and super-tax of Rs. _____ has
also been paid on the same income/part of the same income
amounting to Rs. _____

I am therefore entitled to relief
under the provisions of the India and Burma (Income-tax Relief)
Order, 1936, at the rate of (1) [I have obtained relief under the
provisions of Section 27 of the English Finance Act, 1920, at the
rate of _____ see attached certificate from the Inspector
of Taxes].

I now pray for relief amounting to Rs. _____ under the
India and Burma (Income-tax Relief) Order, 1936. My income
from all sources to which the Income-tax Act, 1922, applies during
the previous year ending on the _____ 19 _____, amounted
to Rs. _____ only—See return of income attached/already
submitted. I attach the official receipt of the Burma income-tax
paid and the notice of assessment, showing the basis on which the
liability has been computed, (3) as also copies of the appellate
order of the Assistant Commissioner and of the Order on revision
by the Commissioner.

Signature.

I hereby declare that what is stated herein is correct. (4) I
further declare that as regards my Burma assessment, I have no

intention to appeal to the Assistant Commissioner or to approach the Commissioner to revise it.

Signature.

Dated 19

40-B. An appeal under the India and Burma (Income-Tax Relief) Order, 1936, shall be in the following form :—

Form of appeal against an order refusing to grant a refund under the India and Burma (Income-tax Relief) Order, 1936.

To

The Assistant Commissioner of

The day of 19

The petition of of

post office, District sheweth as follows :—

Your petitioner applied to the Income-tax Officer for a refund under the India and Burma (Income tax Relief) Order, 1936, of Rs.

The Income-tax Officer has by his order dated the of which a copy is attached rejected the application. granted a refund of only Rs.

Your petitioner therefore requests that the order of the Income-tax Officer may be set aside and the refund asked for may be granted.

Signed.

Grounds of Appeal.

* * * * *

Form of verification.

I, , the petitioner named in the above petition do declare that what is stated therein is true to the best of my information and belief.

Signed."

1. For claimants for relief from triple income-tax only.

2. Where the income on which income-tax has been charged differs from that on which super-tax has been charged both amounts must be specified.

3. In cases in which no appeal to the Assistant Commissioner or petition to revise the assessment to the Commissioner has been made these words or the appropriate part thereof may be struck off.

4. In case an appeal and a revision petition have been made or only an appeal has been made, these words or the appropriate part thereof may be struck off.

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PART XVII.

NOTES & COMMENTS.

THIRTEENTH ANNUAL CONSOLIDATED ADMINISTRATION REPORT OF THE INCOME TAX DEPARTMENT—(YEAR 1936-1937*).

1. **Changes in the Income tax law and procedure.**—During the year under report, the assessment of incomes below Rs. 2,000 introduced by the Finance (Supplementary and Extending) Act, 1931 was abolished. Surcharge, however, continued to be levied, the rate being reduced to 1/12 of the rates of taxes. An important amendment of the Income-tax Act, 1922, was made towards the close of the year in order to stop leakage of revenue through nominal partnerships in business between a person and his wife and minor children and through transfers of assets to an assessee's wife or minor children. Notifications were also issued making minor alterations and additions to Rules 8, 11, 15, 16, 17 and 37A of the Indian Income-tax Rules, 1922. Arrangements for double income tax relief between Kashmir and British India were introduced during the year under report.

2. **Income tax Establishment.**—A new circle was constituted in Madras city by redistributing jurisdiction and it resulted in the abolition of two posts of Assistant Income-tax Officers. Two posts of extra routine clerks in the Guntur II and Masulipatam Circles were abolished and posts of Head Clerks were sanctioned in their places. The temporary Head Clerk's post of the Karaikudi Circle III was also made permanent. A second training reserve post of an Income-tax Officer was sanctioned on a temporary basis on condition that a Telugu speaking Officer was appointed to it. In Bombay 5 Assistant Income-tax Officers, 3 Examiners of Accounts, 5 Inspectors, 18 Assistant Inspectors/ Examiners, 1 Head Clerk, 2 Stenographers, 51 Clerks, 7 Bailiffs, 7 Notice-servers and 22 Inferior servants were sanctioned as a permanent addition to the existing staff while 3 Assistant Inspectors/ Examiners, 1 Senior clerk, 10 clerks, 1 Notice-server and 4 Inferior servants were also sanctioned temporarily. In Bengal 1 Income-tax Officer, 3 Examiners of Accounts and 7 Inferior servants were sanctioned temporarily in February 1937 but these appointments were not made

* The Annual Report for 1937-38 has not yet been published by the Government.

during the year under review. In the Punjab, N.W.F. and Delhi Provinces the cadres of Income-tax Officers, and Assistant Income tax Officers, were amalgamated. The number was reduced from 48 to 44 and 4 Income-tax Officers will be considered supernumerary and will be absorbed as vacancies occur corresponding addition being made in the grade of Inspector-Accountants to serve as leave and training reserve for Income-tax Officers. The two temporary posts of Assistant Commissioners continued during the year.

The tax on 'lower income' was discontinued with effect from 1st April 1936 restoring the minimum taxable limit to Rs. 2000. The greater part of the 'lower limit' staff are retrenched at the end of April 1936. It was not, however, found possible to dispense with the services of all the Officers employed for lower income assessments as there were heavy arrears of work pending. Some of the officers were therefore retained for some months to dispose of the arrears.

Salient features of the previous year's trade.—As income-tax is levied on the income, profits or gains of the "previous year", the assessments made during 1936-37 reflected the trade conditions of the year 1935-36, which are discussed in the following sub-paragraphs based on the reports of the Commissioners of Income Tax.

Madras.—The economic conditions of the year 1935-36 were rather unfavourable. In the northern districts rice and paddy trade was adversely affected partly by the large importation of rice from Burma and partly by the increase in the area of paddy cultivation in His Exalted Highness the Nizam's Dominions. A number of rice mills remained idle and dealers in paddy and rice made little or no profit. Groundnut trade also fared badly owing to utter failure of crops in the Ceded Districts. The cotton crop was poor and cotton mills made smaller profits. The prices of tea, coffee, pepper, copra, arecanuts and potatoes remained more or less at their usual level and there was no appreciable increase in the profits of trade from these commodities. The fall in the prices of agricultural produce affected the income of rural money-lenders who found it difficult to realise their money. There was a large decline in the earnings of the S. I. and M. & S. M. Railway Companies. The income of Nattukottai Chetties underwent a decline owing to low rates of interest prevailing in Burma and the Federated Malay States and also to smaller amounts of remittances received from foreign concerns.

A good part of their capital, being still locked up in lands in Burma, is unproductive from the point of view of income tax. The boom in trade that was expected on the Malabar Coast as a result of the development of the Cochin Harbour has not yet materialised. Business in motor cars yielded fairly good profits. Profits of sugar factories were also larger owing to the imposition of duty on foreign sugar. The business in hides and skins and hardware received a certain amount of impetus from the war atmosphere in Europe. Motor transport business flourished as a result of the elimination of internal competition. There has been increased activity in the film industry which bids fair to develop on successful lines in the near future.

Bombay. The improvement in trade which set in in the year 1934-35 continued until the year under review, though, as was the case in the first year, there was no marked or appreciable increase in the price of important commodities such as cotton on which the major part of the trade of this Presidency depends. On account of a somewhat unsatisfactory and uneven monsoon and severe frost, the cotton crop in the Presidency was below average and the result was that the ginning and pressing factories had not a very prosperous time. There was, however, a welcome rise in the prices of groundnuts and oil seeds and the increased world demand for raw materials would have helped the agriculturists appreciably but the unsatisfactory monsoon damaged their crops in several parts of the Presidency and left them almost where they were. The moneylenders did not experience any better times compared with the previous year on account of the continued low rates of interest and the straitened circumstances of agriculturists. Money continued to be cheap throughout the year on account of gold exports and other world causes and as the prices of Government securities remained at a high level, they did not attract as much money as in the past year owing to the low yield of interest. Investors desirous of having a larger yield on their capital, turned their attention to landed properties. A large number of new buildings were in consequence erected and building contractors and dealers in building materials had a very busy and happy time throughout the year. The price of gold continued to remain high but silver unfortunately had a very bad year as its price rose very rapidly and then collapsed disastrously, involving several big firms in very heavy losses. The improvement in the piece-goods business which was noticed in the preceding year was not maintained in 1935-36. The good effects of the Indo-Japanese trade agreements

and the Indian Tariff Amendment Act were negated by the very severe and cut-throat Japanese competition. Prices fell and though the outturn was larger in several cases, the profits earned by dealers in piece-goods were smaller compared with those in the year 1934-35. The cotton spinning and weaving mills too had, on account of these causes, a less favourable year. Dealers in rice, timber, wines and spirits, grain and mill and gin stores experienced a better year and the legal and medical practitioners kept up their earnings. The salt industry however showed no signs of improvement. The cement industry continued to thrive during 1935-36 as a result of the cement merger scheme which aims at stability by eliminating internal competition. Throughout the year, the demand for cement was on an increasing scale owing to the construction of a larger number of new buildings. For insurance business, the year was brighter and more prosperous but the sugar and match industries suffered a severe set-back on account of increased excise duty. The greatest good fortune befell the Iron and Steel industry on account of a phenomenal rise both in the demand and the price of its products as a result of the political situation in Europe and its consequences.

Bengal.—The year showed no appreciable improvement in the matter of trade and industries as the country cannot be taken as having completely recovered from the economic depression through which it had been passing for several years past. The general tone of trade activities did not however show any downward tendency. Better results were obtained from assessments in tea and jute than in the preceding year. The Tea Restriction scheme continued and there was a noticeable improvement as the export quota in the United Kingdom was reduced in order to reduce the quantity of stock lying there. Paper mills, Electricity and Insurance companies did well. Coal was as bad as before. Very little revenue was realised from engineering and steamship companies on account of the fact that heavy unabsorbed depreciation of the past had to be allowed. Indian piece-goods did well but the results obtained from British and Japanese piece-goods were not satisfactory. Other kinds of business fared tolerably well. There was a drop in the income of petrol and tobacco companies which is attributable chiefly to price cutting competition. The condition of the sugar business went from bad to worse and the mills were running at a loss. There is an accumulation of stocks in the factories. Business in rice and paddy, rice mills, bellmetal in the outlying districts some of which were declared as

scarcity areas did not improve and consequently the condition of moneylenders has been far from satisfactory.

United Provinces.—The trade conditions of 1935-36 were no better than those of the preceeding year and this was particularly the case in the sugar and textile industries. The fall in revenue from sugar factories was due to the imposition of excise duty, fixation of the maximum sale price of cane, and competition. The prices of food grains fluctuated within narrow limits but the traders on the whole fared well. The textile industry presented a very gloomy picture on account of the high price of cotton and low price of cloth. Unfortunately, the price of cotton manufactures did not keep pace with the upward movement of raw cotton. The sales of cloth were badly affected and heavy stocks accumulated in the mills. With regard to jute mills, as a result of the action taken by the Government of Bengal in restricting the area of jute cultivation, the crop was reduced by about 33 per cent and consequently the price of jute went up by 40 per cent. The mills on the other hand in their anxiety to reduce the working expenses, went in for large scale production with the result that the supply of the finished products outstripped the demand and prices fell. As regards hides and leather, Germany which was the biggest buyer of hides has introduced a barter system under which the imports into the country are to be balanced by corresponding exports. The effect of this has been a considerable decline in the volume of business as the markets in the United Provinces found it difficult to adapt themselves to the system. The passage of the Debt Acts has definitely set back the progress of moneylending business and owing to scanty cash realisations money-lenders have become rather shy and apprehensive regarding fresh advances. The situation has been accentuated by the agriculturists and Zamindars taking full advantage of the debt legislation. The result has been that pawning business is gaining ground and fresh devices are being adopted to defeat the purpose of legislation. It is now not unusual to find a bond executed for a sum much higher than the actual amount advanced. The year witnessed almost a total collapse of the shellac industry. Oil factories earned good profits owing to a rise in the price of mustard. Conditions of trade in iron and hardware were normal.

Punjab.—Trade conditions did not show any appreciable improvement owing to world-wide economic depression. This stagnant state of affairs is bound to continue till the purchasing power of the agricultural classes of the Province as a whole rises. There

was a rise under urban moneylending but there was a great fall under rural money-lending, cotton ginning and contract works. There is a tendency on the part of the investor to divert his capital to purchase or construction of property as the rates of interest on money-lending business have been considerably reduced. There was appreciable improvement in timber trade. Sugar mills showed an upward tendency as compared with last year. Agricultural produce showed a little briskness but owing to losses in cotton no appreciable change for the better was visible. Cotton factories suffered heavy losses as a result of the price of cotton having gone down in Multan and Lyallpur canal colonies. There was decrease in piece-goods retailing owing to the lack of surplus cash and wider competition coupled with closure of Amritsar market. Hosiery trade in Ludhiana district did well.

Burma.—The commodity having the greatest direct effect on the income tax figures is oil, and the rise in production and price levels was reflected in the profits of the companies. The profits from production of mineral ores is also a notable detail among the "company" assessments particularly lead, etc., from companies working in the Shan States and the tin and wolfram from the southern coastal areas. Prices advanced, and production with it and correspondingly the income tax yield. The quantity of timber exported also increased, and though prices did not advance much, there was an increase in the ordinary income tax yield from this industry. Cotton prices had a set back under world-trade influences. Rubber prices continued to raise parallel with quota restriction. The prices of piece-goods fell, under world market conditions. The prices of most other imported commodities did not rise nearly as much as those of exported commodities, but the total values imported generally showed increase. Generally speaking all merchants and retail traders had a better year. The purchasing power of the people increased, and turnover increased accordingly. The realisation by money-lenders improved appreciably but the assessed profits have only slightly improved.

Bihar and Orissa Provinces.—The trade conditions of the year remained practically unchanged and certain industries suffered a further set-back. The slump in the coal and shellac markets continued throughout the year. The coal mines passed through a crisis of a serious nature and this necessitated stoppage of work in several mines, but, in spite of the slump, there was a steady increase in the output of coal. The income of royalty receivers, who contribute a considerable part of revenue in the coal area, was

not much affected by the slump, their incomes not being dependent on the profits made by the miners. The coal-raising contractors also were able to maintain their level of profits by doing a larger amount of raisings, although the rates were lower than before. Copper and iron products had a very prosperous year on account of increased demand, probably due to the world-wide re-armament policy. Timber and *Bidi* trades did not have a very bad year on the whole. The market for cotton and cloth twists was not very favourable. The gold and silver market was favourable. The markets of paddy, grain and forest produce were comparatively dull. There was a slight improvement in the jute trade. On account of the prevailing economic depression the condition of the money-lenders went from bad to worse and they could not recover any appreciable amount of their dues. Bhagalpur silk and *tassar*, as well as the other allied industries, had a very favourable year due to an abrupt rise in the price on account of the imposition of additional duty on Japanese yarn. The sugar industry on the whole had a very unfavourable year owing to fall in the price of sugar and dullness in the sugar market. Rice and oil mills did fairly well, the latter on account of a rise in the price of oil seeds.

Central Provinces and Berar.—Like its immediate predecessors, this year also proved to be one of trade depression. The Province is mainly an agricultural one and fluctuations in the price of the principal agricultural products govern the fortune of the people residing there. As regards cotton, although the average rate per *Khadi* increased as compared with that in 1934-35, the benefits of the higher rate were off-set by the poorer outturn. The ginning and pressing concerns, too, did not fare well on account of poor outturn of *Kapas*. No perceptible change was noticeable in the grain and other allied businesses. Owing to the increase in the rice mills in the Chattisgarh Division, competition became very keen resulting in the reduction of individual profits. Owing to the establishment of Debt Conciliation Boards and the passing of legal enactments, such as the Usurious Loans Act and the Money-lenders Act, the income of money-lenders and members of the legal profession in general fell considerably. *Bidi* business fared well. Lac did not do so well as in the past year. Trade in manganese, coal and limestone also continued to be dull. Dealers in cloth and general merchandise too did not do better under adverse trade conditions. The gold market was practically steady but the fluctuations in the price of silver affected the dealers

adversely. Shoe merchants were badly hit owing to the popularity of cheap Japanese shoes in the market.

Assam.—The yield from the tea industry in the year was more or less on a par with that of the previous year. Profession and business of all types except trade in ordinary agricultural crops showed slow and steady improvement. The money market is still very tight, so the indigenous moneylenders and banks are not having a very happy time. The Assam Moneylenders Act which came into force from the beginning of 1935-36 has adversely affected this kind of business.

4. Demand, Collection, etc.—The following figures show the demand and progress of collections during 1936-37 as compared with the two preceding years :—

	<i>Income Tax.</i>		
	1934-35	1935-36	1936-37
Balance on 1st April	62,17,018	58,63,958	81,63,927
Demand	17,55,45,098	17,31,40,911	15,24,63,668
Miscellaneous and penalties	10,49,876	6,97,600	5,89,545
Total Demand	18,28,11,992	17,97,02,600	16,12,17,140
Refunds	3,25,81,181	3,13,92,703	3,28,31,911
Net Demand	15,02,32,073	14,83,09,766	12,83,85,229
Net collections	14,85,03,228	13,90,21,668	11,83,37,327
Excess collections and advance payments	7,31,887	4,53,088	3,23,022
Unpaid refunds for the year under review	3,92,416	4,04,214	3,85,057
Paid refunds out of unpaid refunds for the previous year	4,27,363	3,54,202	3,50,743
Balance on 31st March	74,25,789	97,91,378	1,94,05,538
	<i>Super-tax.</i>		
Balance on 1st April	25,04,473	17,04,364	21,87,521
Demand	3,17,12,373	3,27,12,038	3,21,87,511
Miscellaneous and penalties	5,875	689	2,645
Total Demand	3,42,22,721	3,44,17,091	3,43,77,677
	1934-35	1935-36	1936-37
Refunds	17,43,163	13,16,731	14,95,841
Net demand	3,24,79,558	3,31,00,860	3,28,81,836
Net collections	3,16,73,111	3,14,53,908	3,05,87,631

Excess collection and advance payments	14,65,929	15,03,726	8,38,942
Unpaid refunds for the year under review	2,972	3,626	4,534
Paid refunds out of unpaid refunds for the previous year	3,543	22	10,619
Balance on 31st March	22,71,805	31,53,782	31,27,362
<i>Total Income-tax and Super-tax.</i>			
Balance on 1st April	87,21,491	75,68,322	1,03,51,448
Demand	20,72,57,471	20,58,52,949	18,46,51,179
Miscellaneous and penalties	10,55,751	6,98,289	5,92,190
Total demand	21,70,34,713	21,41,19,560	19,55,94,817

Refund	3,43,24,344	3,27,09,484	3,43,27,352
Net demand	18,27,11,635	18,14,10,126	16,12,67,065
Net collections	17,51,76,339	17,04,75,576	14,89,24,058
Excess collections and advance payments	21,97,316	13,56,814	11,61,964
Unpaid refunds for the year under review	3,95,388	4,07,655	3,19,591
Paid refunds out of unpaid refunds for the previous year	4,30,906	3,54,044	3,61,362
Balance on 31st March	96,97,594	1,29,44,025	1,35,32,600

N.B.—The difference between the closing balance and the opening balance of the following year is due to reductions of amounts outstanding effected in the course of the second year through reduction of assessments in appeal or revision or through the writing off of amounts as irrecoverable.

5. The number of (1) new assesseees discovered and (2) those removed from the register of the Department, during 1936-37, were as follows :—

Province	Discovered	Struck off
1. Madras	20,753	8,721
2. Bombay	8,342	6,794
3. Bengal	6,514	4,789
4. United Provinces	3,165	2,797
5. Punjab	13,925	5,270
6. Burma	3,373	1,962
7. Bihar and Orissa Provinces	2,690	1,440
8. Central Provinces and Berar	1,033	1,767
9. Assam	984	778
10. N.W.F.	1,154	246
11. Delhi	1,847	747
	<hr/> 63,780	<hr/> 34,491

6. If the returns made by the assessees had been accepted as correct without change a sum of Rs. 2,85,43,852 or about 25. 4 per cent. of the actual revenue assessed on those persons would have been lost.

7. **Summary procedure**—The summary procedure introduced by the Indian Finance (Supplementary and Extending) Amendment Act, 1931, were repealed with effect from 1st April 1936.

8. **Tramp steamers.**—The net collections realised in the maritime provinces during the year under review were—

Madras	Rs. 58,565
Bombay and Sind	44,148
Bengal	19,069
Burma	33,759

1,55,536

9. As a result of the collation of the returns submitted by the Principal Officers of Companies under Section 19-A of the Indian Income-tax Act, 1922, by the All India Collating Officer at the headquarters of the Board, an additional revenue of Rs. 3,829 was obtained during 1936-37.

10. **Method of evasion.**—Attempts at evasion of tax continued during the year under report despite the launching of prosecutions by the Department in criminal courts in the past and fines and penalties imposed from time to time. Various devices for evasion of tax such as double sets of accounts, false totals, false purchase figures, undervaluation of stock, suppressed sales, opening bogus accounts to conceal the real income, concealment of subsidiary business and branches, payment of interest commission to fictitious persons described either as residents or as non-residents and suppressing sources of income, were all resorted to by the assessees and detected by the Department and the offenders dealt with under Sections 28 and 53 of the Income-tax Act, 1922. The Department employed their usual methods to counteract evasive tactics. Some examples of attempted evasion are given below :—

(a) An assessee returned a loss of Rs. 719 but the examination of his accounts showed that he had been habitually concealing his income by various devices and escaping adequate assessment for some years. His income was finally ascertained to be Rs. 55,283 and the Income-tax Officer imposed a penalty of Rs. 5,000 in addition to the tax.

(b) An assessee used to conceal a portion of his profits by crediting it to the account of one of his minor sons. This device was detected and he was made to pay a penalty of Rs. 650.

(c) An assessee dealing in cloth filed a balance sheet which tallied to the fraction of a pie. On a closer scrutiny it transpired that the balance sheet prepared was a bogus one inasmuch as several accounts were found missing. Pursuing this thread the accounts were checked in minute details and the totals of the cloth account were found to be completely wrong. After strenuous efforts copies of assessee's accounts in the books of several merchants were obtained and several omissions were discovered. Thus the concealment was proved to the hilt and the assessment was made on an income of Rs. 16,448 as against Rs. 3,121 returned by the assessee. A penalty of Rs. 1,200 was also imposed.

(d) A silk-yarn dealer and money-lender tried to conceal his income by entering partial transactions in his books. He went to the length of entering bogus cash purchases. Figures of purchases and sales were collected from the accounts of local dealers which exposed the guilt of the assessee. Assessments for 1935-36 and 1936-37 were made on incomes of Rs. 12,251 and Rs. 23,024 respectively and penalties under Section 28 amounting to Rs. 400 and Rs. 1,500 respectively were also imposed.

(e) Regular and systematic concealment was made for a number of years by an assessee supplying Benares cloth. After strenuous efforts definite instances of omissions of sales from the accounts of the assessee's customers were collected. It was also found that the purchases were inflated. A good many such instances were collected and the assessee was called upon to explain. He could not give any satisfactory explanation and the accounts having been proved to have been fabricated for income-tax purposes were rejected and assessment was made on an income of Rs. 51,423 against Rs. 12,440 shown by him. This case was also recommended for prosecution but was subsequently compounded on payment of Rs. 5,000.

(f) An assessee returned an income of Rs. 1,494 but was finally assessed on Rs. 22,742. It was found that Rs. 28,100 on account of adjustment for the old pool account of the assessee firm was shown in the personal account of one of the parties to avoid proper taxation.

(g) An assessee paid a tax of Rs. 478 in 1934-35 and of Rs. 647 in 1935-36. The transactions shown in his books however did not tally with the reputation of his business. A surprise visit was paid to his residence and it was detected that duplicate books were kept by him. Basing the assessments on the real set of books, a sum of Rs. 1,827 was recovered as tax and Rs. 1,375 as penalty.

(h) An assessee used to enter some of his transactions in a separate set of books which were never produced before the Income-tax Officer and the profits whereof were never disclosed. Enquiries at the shop and from others resulted in detection of the same. Even in the returns under Section 34 for 1934-35 and 1935-36 the income in question was not disclosed. Penalties under Section 28 and additional taxes for these years amounting to Rs. 1,746 were realised. He also paid Rs. 2,221 for 1936-37, though previous to his detection he never paid more than Rs. 400 in any year except once in 1932-33.

(i) Two employees of a Railway failed to show their income from interest on bank deposits in their returns. The information was received from extracts of return under Section 20-A of the Act in the case of one and from Bank pass book and other sources in the case of the second. Maximum penalty was imposed in both the cases.

11. The arrears at the close of the year under review were more than at the close of the previous year.

12. **Coercive Measures** (Vide Return No. VII). There was a large decrease from 25,730 to 13,005 in the number of cases in which penalties were imposed.

13. No prosecution was instituted in Madras, Bombay, Punjab, Burma, Bihar and Orissa and Assam. In Bengal, a prosecution was lodged against an employer for failure to file annual returns under Section 21 for the year 1934-35 in spite of several reminders. The case was pending before the court at the end of the year under report but it has been withdrawn this year on submission of the return by the employer and the latter having undertaken to pay up the arrear tax due. In two cases of partners of a registered firm, there was an attempt to avoid super tax by concealing income from interest on securities. These cases were compounded and a penalty amounting to Rs. 4,100 was realised. In the United Provinces prosecutions were launched in three cases and resulted in conviction in two cases. In the third case, the prosecution was withdrawn. In Bihar and Orissa and Assam one case each was compounded, while in the Central Provinces eleven cases were compounded for Rs. 22,000

14. **Appeals.**—29,025 appeals were filed in the year under report against 31,037 in the previous year. The number of cases taken up by the Commissioners of Income-tax in revision was 6,490 against 6,543 in the previous year. 15,080 appeals were successful (including partially successful). Orders were modified in 2,981 cases in revision against 3,144 cases in the previous year.

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PART XVIII.

NOTES & COMMENTS:

Clause 42 of the Income Tax Amendment Bill an Unconstitutional Measure.

Clause 42 of the Income Tax Amendment Bill, XI of 1938, provides that the Income Tax Officer or the Income Tax Inspector may, for the purposes of the Income Tax Act, enter between sunrise and sunset the premises of any person liable or believed by him to be liable to assessment and may make therein any enquiries he considers necessary; and that the Income Tax Officer may while on any premises so entered, call for and inspect any such person's account and may stamp any accounts of any such person so inspected.

Even a cursory glance into the history of civilized nations would tell us that "the inviolability of the dwelling is, next to freedom from arrest, *the oldest personal right recognized by the State*" and that "it has been one of the first to be embodied in the formal records of such recognition": *Dr. Kohn's Constitution of the Irish Free State*.

Englishmen are taught from their boyhood that 'the Englishman's house is his castle'. There the principle is firmly established that "just as the subject has a right to personal freedom so also has he the right to prevent others entering his house without justification": *Chester v. Bateson* (1920, 1 K.B. 829). It has even been held in the leading case of *Entick v. Carrington* that a general warrant to break into a house and search for the papers of a person not named cannot be issued and if issued would be invalid in law.

In the United States of America inviolability of a citizen's dwelling is held so sacred that this right is declared in the

Constitution of the States itself. Article IV of the Supplemental Articles provides: "The right in the people to be secured in their persons, houses, papers and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the places to be searched, and the persons or things to be seized."

The French Constitution of 1848 declares inviolable "the residence of every person dwelling in French territory": (Vide Chapter II, Article 3).

The Irish Constitution Act of 1922 provides that "The dwelling of each citizen is inviolable and shall not be forcibly entered except in accordance with law": (Art 7).

The recent constitutions of Europe contain a Declaration of Fundamental Rights of the people—rights which are in principle not to be subject to interference by the Legislature—and power is given to the Courts to declare invalid laws which violate the fundamental rights declared by the Constitution (compare, for instance, Art. 65 of the Irish Constitution). This declaration includes the classic guarantees of individual liberty contained in the American and French Constitutions. The provision of the Irish Constitution guaranteeing the security of the dwelling against administrative interference which we have quoted above is drawn upon the model of these Continental declarations, though more cryptically worded.

It is very regrettable that the Government of India should contemplate a measure which, in effect would, by a single stroke, issue a general warrant to all income tax officers in India for all time to come, to enter the house of any person they like, wherever it may be situated, and to search for whatever papers they like. What a contrast to Art. IV of the constitution of the United States quoted above!

It is clear to us that the Government has not fully realised the constitutional importance of the right of inviolability of the dwelling. We hope better counsel would prevail before the Bill is enacted, and that the Government of India will not deprive the citizens of India of a right which has been held sacred and inviolable by every European and American nation; which has been universally recognised as one of the fundamental rights of the citizen; and which has been enshrined with the greatest veneration in the constitution of all civilized nations,

Foreign Exchange Business : Govindram Seksaria's Case.

Our readers are sure to remember the case of *Chunilal Mehta*, the judgment of the Bombay High Court which was recently affirmed by the Privy Council (1938 I.T.R. 521). This case establishes that a person resident in British India carrying on business here and controlling transactions abroad, e.g., in New York, in the course of such business, is not by these mere facts liable to be assessed on the profits of such transactions. Unless the profits accrue or arise or are received in British India or are deemed to accrue or arise or to be received here, the profits cannot be taxed under the Indian Income Tax Act. The case of *Govindram Seksaria*, a decision of the same High Court reported at p. 584, has to be carefully distinguished from *Chunilal Mehta's* case. The nature of the transactions were very similar but a single circumstance made a world of difference and made the profits taxable in India. Instead of placing orders for the purchase and sale of cotton with the New York brokers direct as in *Chunilal Mehta's Case*, the assessee in this case placed his orders with another firm of brokers in India who in their turn dealt with the New York firms. The Commissioner held that the assessee's dealings were with the Indian brokers and that they had no privity of contract with the New York firms. So far as the New York firms were concerned they did not deal with the assessee and did not look to them for payment of loss or profits. The assessee's contracts were with the Indian brokers, they were entered into in India, and the profits therefrom accrued in India. This decision was upheld by the High Court.

In this case the intermediaries appear to have acted on their own account with the foreign firms and not as agents, disclosed or undisclosed, of the assessee. They placed orders for the assessee and other constituents in one lot and allocated the profits between their constituents as they chose. If the Indian brokers had acted merely as agents of the assessee in placing orders with the foreign firms, we think the mere fact that the assessee had engaged other brokers as intermediaries would not be material. The agents would disappear from the scene of legal liability and the case would fall within the principle of *Chunilal Mehta's Case*. But if the assessee looks to the Indian brokers alone and leave the latter to deal with the foreign firms on their own account as in *Govindram Seksaria's Case*, so far as the assessee is concerned, the profits would accrue in India. The crucial point, the nature of the contract, has to be carefully determined in such cases.

Time Limit for Imposing Penalty.

It was contended in a recent case which came up before the Lahore High Court, *Vir Bhan Bansi Lal v. Commissioner of Income Tax, Punjab* (1938 I.T.R. 616) that the income tax authorities have no power to impose a penalty under Section 28 after an assessment order has been made and tax has been paid; in other words, if they want to impose a penalty they must do so before the assessment order is made or simultaneously with it. The argument was based on the words 'in the course of any proceedings under this Act' occurring in Section 28. The Commissioner of Income Tax took the view that these words merely relate to the time for initiation of proceedings and did not mean that the proceedings relating to penalty must be completed within that period. The learned Judges of the Lahore High Court said that this is the only reasonable construction that can be put upon the section.

Though the question does not seem to be one of difficulty, their Lordships think that it is desirable to amend the language of Section 28 so as to make its meaning clear. They say :

"We further draw the attention of the Commissioner to the desirability of approaching the Central Legislature with a view to remove the ambiguity that exists in the language of Section 28 as the matter of amending the Income Act is already on the tapis."

Dairy farm : Income Derived From Sale of Milk.

The *Kokine Dairy Farm Case* has brought to light the difficulties in assessing a dairy farm and we had occasion to refer to this topic in one of our earlier issues. We may draw the attention of our readers to the following observations of LORD JUSTICE SCRUTTON in *Back v. Daniels* (9 Tax Cas. 183) which were quoted verbatim with approval by VISCOUNT DUNEDIN in the *Salisbury House Estates Case* (15 Tax. Cas. 266).

"When there is a separate and distinct operation unconnected with the occupation of land such as a cheese factory dealing with the materials of a dairy farm, or a butcher's shop dealing with the beasts of a cattle farm, I can understand a separate assessment of that operation, but I do not think the fact that the farmer sells his produce either on the farm or at the local market or in Mark Lane, or even if he sells it in a shop, justifies an assessment under Schedule D, as well as or in substitution for, an assessment under Schedule B."

**Foreign Income : Inclusion in Profit and Loss Account and in
Determining Dividend, Whether Constitutes ' Receipt '.**

NEW INDIA ASSURANCE CO.'S CASE (1938 I.T.R. 603).

The judgment of the Bombay High Court in the *New India Assurance Co.'s Case* (reported below at p. 603) deals with a question of general importance relating to foreign income and investments. Under the Indian income tax law as it stands at present income earned abroad can be assessed to income tax only if it has been received in British India or can be deemed under the Act to have accrued or arisen or to have been received in British India. In the *New India Assurance Co.'s Case* the question was whether when interest from foreign securities is not actually brought into British India but is included in the profit and loss account in arriving at the profits of the year and is also taken into account in determining the amount which could be paid as dividend to the shareholders, such income can be said to be 'received' in British India and assessed to Indian income tax. The High Court (Beaumont, C.J., and Kania, J.) answered the question in the negative. The Chief Justice said : " The mere fact that the amount of the income has been brought into account in ascertaining the profits for the year and has been taken into account also in determining the amount payable in dividend seems to me irrelevant unless it be proved that this actual income has been received in India and applied in payment of dividend, and that is not shown. The case seems to me to be covered in principle by the decision of the House of Lords in *Gresham Life Assurance Society v. Bishop* (1902 A.C. 287) ".

KANIA, J., was also of the same view.

From a business point of view it is difficult to see why if a company not only includes its foreign profits in its balance sheet to show its financial position to the public but treats it as income available in India for payment of dividend, and disposes of it in that way, it could not be taxed in India on it. If it is clear that the intention of the company is to pay dividends out of the foreign profits, the absence of actual remittance of the particular foreign income would be immaterial. Actual remittances are rarely necessary or resorted to by business people when other funds are available. The real significance and effect of the entries in the

accounts is the guiding factor in such cases and not the absence or presence of actual remittance.

We have carefully gone through all the English cases on the subject, and but for the case of *Gresham Life Assurance Society v. Bishop* we would have had no hesitation in strongly supporting the view that when foreign income has not only been shown as profits in the balance sheet but has also been treated in the accounts as profits available for distribution in India as dividend and disposed of in that way in India, it is taxable in India even though that income has not been actually remitted to India. *Mc. Kelvie's Case* (2 T.C. 165) and the case of *Universal Life Insurance Co. v. Bishop* (4 T.C. 139) are ample authorities to support that view. *Gresham Life Assurance Society v. Bishop* is a decision of the House of Lords, it is entitled to the greatest respect, and at first sight would appear to be conclusively against that view.

An anxious consideration of that case has however convinced us that that case is distinguishable :—

It is a decision on the meaning of the word 'receipt' as used in the English Income Tax Act with reference to interest on foreign securities, in respect of which the provisions of the said Act are admittedly peculiar and strict. It is important in this connection to note the following passages in LORD HALSBURY'S judgment in that case :

"It is to be observed that the Legislature has assumed by the distinction which it has made between the mode of ascertaining the amount payable generally upon the balance of gains and profits and the amount taxable in respect of the interest payable upon foreign investments, *that it had ear-marked that sum and made it subject to distinct and peculiar incidents.....The Legislature must be supposed to have contemplated the possibility of drawing a distinction between money received in this country and money accounted for and credited in account.*"

Again: "If the Legislature had intended that bringing it into account was to be equivalent to its being received it would have been easy to say so. It cannot be said that the use of artificial meaning to be attached to ordinary language is either unknown or unusual in legislation; and *if it was intended to make this a special subject of taxation, to be taxed whenever and wherever an equivalent amount was credited or booked, or in any other way recognised as having come under the dominion of the owner in this*

country, nothing could have been easier than to enact it in plain terms."

Again: "*I do not think any amount of book keeping or treatment of these assets, wherever they may be will be equivalent to or the same thing as receiving the amount in this country.*"

The English law, it has to be noted, treats income from foreign investments in a different way altogether from other kinds of foreign income, and Lord Halsbury's remarks clearly show that the English Legislature in making provision for income from foreign investments wanted to make a distinction between income 'received' and income accounted for or credited in account. Indian law treats all foreign income on the same footing and the Indian Legislature had no necessity for making any such distinction.

So far as we have been able to follow the scheme of the Indian Income-tax Act and Indian case law the word 'received' has always been used in a sense which includes getting control over the amount by appropriate adjustments in accounts by cross entries. Foreign income, *e.g.*, has generally been treated as received in India when appropriate entries are made in the books of the Head Office and the foreign branch. It has never been used in the strict sense in which it has been used with reference to interest on foreign securities in England.

Even in the judgment in the *New Indian Assurance Co.'s case*, the subject of this comment, the Chief Justice says: 'I think further, that it might be received in account, by means of cross entries. If for example, it were shown that a sum representing income received abroad had been exchanged by appropriate book entries, for an asset in India, and had then been applied as income in India I should say, that the foreign income had then been received in India.'

There can be no doubt that the word 'received' is used in the Indian Income-tax Act in the above sense and not in the strict sense put upon that word in *Gresham Life Assurance Society v. Bishop* with reference to foreign investments in England.

In view of the fact that in England foreign income is divided into two classes, one class taxable though not received in England, and the other taxable only if received and without any allowances whatsoever, it is necessary to understand the word 'received' used

with reference to income from foreign investments in the sense of actual receipt of that particular income. But this latter kind of income is treated just like other foreign income in India and there is no necessity or justification for introducing such a strict refinement in the meaning of 'received'.

Another important fact which has to be remembered in connection with *Gresham Life Assurance Society v. Bishop* is that in that case *the company paid and was willing to pay income tax on the entire amount shown as profits (after including the foreign income) and distributed as dividend*. The foreign income was £143,483, the total profits after including that income was £17,342. The company paid tax on £17,342 but the Crown wanted tax on £143,483. The House of Lords rejected its claim. The decision is quite consistent with justice and commonsense. The case would have been parallel to the *New India Assurance Co.'s case* if the company had refused to pay tax on £17,432 and the Court had said that the company was not bound to pay tax even on that sum. To consider the matter the other way: In the *New India Assurance Co.'s case* the Indian profit was Rs. 3 lacs, foreign profit 2 lacs, and 5 lacs were distributed as dividend. If the company had distributed only 4 lacs as dividend, and the Crown had claimed tax on the remaining one lac also of the foreign profit which was merely included in the profit and loss account but had not been treated as income available in India and distributed, *Bishop's case* could be applied to that one lac.

We think a distinction can and ought to be drawn between cases where the foreign income is merely included in the profit and loss account to show the financial position of the company, and cases where the foreign income has been further treated in the accounts as income available in India and distributed as dividend or otherwise disposed of, and that *Bishop's case* read with its facts, as it ought to be read, is no authority for the view that even in regard to the extent of profits actually distributed, tax is not payable. The principle applied in *Mc. Kelvie's case* (2 Tax Cas. 165) and *Universal Life Insurance Co. v. Bishop* (4 Tax Cas. 139) is more applicable to the second class of cases than that laid down in *Bishop's case*. There is also no justification for introducing into India the finely refined meaning in which the word 'received' is used with reference to interest on foreign securities in England.

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PARTS XIX—XX

NOTIFICATION.

The following notification has been published in the Gazette of India Dated 8th October 1938, p. 1627.

No. D/3620-P.T./38. Under the rules for the guidance of depositors in Post Office Savings Banks as published with the late Department of Commerce and Industries Resolution No. 1446-1449-29, dated the 5th March 1914 and subsequently amended, interest on income-tax bearing securities issued by the Government of India, which are purchased through the Post Office and left in the custody of the Accountant General, Posts and Telegraphs, is exempt from income-tax, this exemption being limited, however, in the case of each investor, to securities of the normal value not exceeding Rs. 22,500. The Governor-General in Council has had under consideration for some time past the desirability or otherwise of the continuance of this concession and he has now decided that it should be withdrawn in the case of all savings banks accounts, with effect from the 1st April 1939.

2. Amendments to rules for the guidance of depositors in Post Office Savings Banks in accordance with this decision will be made shortly.

Sd. J. C. NIXON,

Secretary to the Government of India.

The following notification which will be of interest to our readers has been published in the Gazette of India dated 24th September 1938, p. 1589-90

No. 1-A (7)/37 (i)—In exercise of the powers conferred by Sub-section (2) of Section 144 of the Indian Companies Act, 1913 (VII of 1913), the Central Government is pleased to direct that the following further amendments shall be made in the Auditor's Certificates Rules, 1932, the same having been previously published as required by the said Sub-section, namely :—

1. For rule 31 of the said Rules, the following rule shall be substituted, namely :—

“31. The fee paid by a candidate who has been admitted to an examination shall not in any circumstances be refunded. If such a candidate is subsequently prevented from attending the examination to which he was admitted, the Central Government may, if it is satisfied that he was prevented from attending by circumstances beyond his control, permit the fee to be transferred to the next examination”.

2. In rule 45 of the said Rules, for the words “any complaint of misconduct or” the words and figures “any complaint of misconduct or a breach of rule 44 or a” shall be substituted.

3. In Appendix 3 to the said Rules, to the “List of acts and omissions by an accountant enrolled on the Register which are deemed to be breaches of professional propriety” the following shall be added, namely :—

“(10) Authorising any person in India who is neither a Registered Accountant nor a holder of a restricted certificate to sign on his behalf any balance sheet, profit and loss account, report or statement”.

No. 1-A (7)/37 (ii) :—In exercise of the powers conferred by Sub-section (2) of Section 3 of the Indian Companies (Amendment)

Act 1930 (XIX of 1930), the Central Government is pleased to direct that the following further amendment shall be made in the Restricted Certificate Rules 1932, the same having been previously published as required by the Sub-section, namely :—

In the Appendix to the said Rules, to the “List of acts and omissions by an accountant subject to these Rules which are deemed to be breaches of professional propriety” the following shall be added, namely :—

“(10) Authorising any person in India who is subject neither to the Auditors Certificate Rules, 1932, nor to these Rules to sign on his behalf, any balance sheet, profit and loss account, report or statement”.

No. 4-A (1)/37. The following draft of a further amendment to the Auditor's Certificates Rules, 1932, which it is proposed to make in exercise of the powers conferred by sub-section (2) of Section 144 of the Indian Companies Act, 1913 (VII of 1913), is published, as required by the said sub-section, for the information of all persons likely to be affected thereby and notice is hereby given that the said draft will be taken into consideration on or after the 24th October 1938.

Any objection or suggestion which may be received from any person with respect to the draft before the aforesaid date will be considered by the Central Government.

DRAFT AMENDMENT.

For rule 39 of the said Rules, the following rule shall be substituted, namely :—

“39. The Central Government may remove from the list of Approved Accountants the name of any person—

(a) whose name has been removed from the Register of Accountants, or

(b) who has ceased to practise as a Registered Accountant in India, or

(c) who has ceased to be a partner in the firm of Registered Accountants in which he was a partner at the time when his name was included in the list of Approved Accountants, or

(d) whose name was wrongly or inadvertently included in the list, or

(e) who in its opinion is no longer a fit and proper person to employ articled clerks, or is no longer in a position to train articled clerks, or

(f) who has expressed a desire to that effect, and such removal shall be notified in the Gazette of India.

Provided that before removing the name of any person under clause (b), (c), (d) or (e), the Central Government shall call upon the person concerned to show cause why his name should not be removed".

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PART XXI.

NOTES & COMMENTS.

Foreign Income : Receipt in British India Through Book Entries.

The decision of the Allahabad High Court in *Kanwalnen Hamir Singh v. Commissioner of Income Tax* reported below at p. 675, is of much importance to assesseees having branch offices outside British India, though it does not involve any difficult question of law. This decision shows also some of the disadvantages of adopting the mercantile system of accounting for income-tax purposes. The assesseees, a Hindu undivided family had their headquarters in Ajmere in British India, and branch offices in the States of Tonk and Jaipur. Their accounts were kept in the headquarters, as well as in the branch offices, on the mercantile system. In the accounts of the Tonk and Jaipur offices certain items of income were credited to the Ajmere office, though no sum was actually remitted to Ajmere. The profits and losses of the branch offices were also taken into account in making a return of income for income-tax for several years. In the particular year in question the assesseees contended that the entries in the Tonk and Jaipur accounts were merely book entries, the income which had accrued in Tonk and Jaipur had not really been remitted to or received in British India and that such income could not, therefore, be taxed in British India. On behalf of the Income-tax authorities it was argued that though the income was not actually remitted to British India it must be deemed to have been received in British India in the circumstances of the case. The High Court held that as the method of accounting adopted by the assesseees was the mercantile system and the income which had accrued in Tonk and Jaipur had been credited to the Ajmere office in the accounts books, that income must be deemed to have been received in Ajmere and was therefore, taxable in British India.

In the circumstances of the case we have no doubt that the decision is correct. As the assesseees had adopted the mercantile system of accounting and had credited the foreign profits to the

head office in British India it was not open to the assesseees to say that such profits were not received in British India.

We think, however, that the observation of the learned Judges that under Section 13 of the Act the assesseees could not change the method of accounting goes too far. In this case the assesseees had not taken any steps whatever to change their system and therefore they were rightly assessed. But the adoption of the mercantile system for a number of years cannot debar an assessee from changing that system, of course, without prejudice to the collection of income-tax. If the assesseees had discarded the mercantile system once for all and adopted the cash system we think the income-tax authorities would have been bound to permit them to adopt the cash system. (*Vide, e.g., Sarupchand's Case*: 1936 I.T.R. 420).

Meaning of "Received in British India".

In commenting upon the *New India Assurance Company's Case* (1938 I.T.R. 603) in one of our earlier issues, we had stated that the interpretation put upon the words "received in the United Kingdom" of the English Income Tax Act, in *Gresham Life Assurance Society Limited v. Bishop* (1902 A.C. 287) is not a safe guide to the interpretation of the words "received in British India" in the Indian Income Tax Act. The Scheme of the English Act shows that the expression "received in the United Kingdom" as applied to foreign securities is used there in a very restricted sense connoting actual receipt. For the purposes of the Indian Income Tax Act entries or adjustment in accounts which amount to receipt for commercial purposes would amount to receipt of income in British India. We are glad to find that the Allahabad High Court have also taken this view in the abovementioned case. Referring to the *Gresham Life Assurance Society's Case* and to the meaning given to the expression "received in the United Kingdom" by the House of Lords in that case, the learned Judges say this:

"In our view the English authorities can be of little assistance in this case, because the statute which was under consideration in *Gresham Life Assurance Society Limited v. Bishop* did not contain everything which is contained in Section 4 (1) of the Indian Income Tax Act. As we have already pointed out the sub-section provides that the Act is to apply not only to income, profits or gains accruing or arising or received in British India but also to all

such income, profits and gains which are deemed under the provisions of the Act to accrue or arise or received in British India. There was nothing corresponding to the latter provision in the Income Tax Act 1842 which was under consideration in the House of Lords case to which we have referred."

Loss in Shares : Whether Capital or Trading Loss.

Commissioner of Income Tax, Bihar and Orissa v. Maharaja-dhiraja of Darbhanga (reported below at p. 686) affords an instance where loss incurred in respect of money invested in shares was held to be a capital loss as distinguished from a trading loss. The Maharaja took some shares in a company. The company was wound up and a new company which was formed to take up the assets of the old company agreed to give debentures of a certain value to the Maharaja in lieu of his shares in the old company. This company was also wound up before the debentures were issued and the Maharaja received only a very small fraction of the amount which he had originally invested in shares. He claimed that the loss which he had thus incurred was a trading loss which he was entitled to deduct from his income, but the Patna High Court ruled against him. Their Lordships were of opinion that the loss was clearly a capital loss, as there was nothing to show that the Maharaja carried on the business of dealing in shares. The argument that the agreement of the new company to give him debentures made the transaction a loan to the new company and thus a part of his money-lending business, was also not accepted by the Commissioner and the High Court.

Necessity of Amending the Present Law As to Relief from Dominion Income Tax (Sec. 49).

We understand that the Chairman of the All-India Congress Parliamentary Sub-Committee, has sent telegrams to the Premiers of the various provinces advising them to request the Governor-General to delete Section 49 of the Income-tax Act.

The telegram says that under this section foreign companies and British nationals operating in India get certain exemptions from Indian income-tax, the aggregate value of which is Rs. 1,30,00,000 per annum, while under the reciprocal arrangement Indians and Indian companies operating in England get merely three lakhs a year. If this section is deleted and if the reciprocal arrangement is cancelled, the Government of India will annually save Rs. 1,27,00,000, which could be distributed to the provinces under

the Niemeyer Award and will be a substantial help to the provinces which are badly in need of funds. The Chairman has advised the Provincial Premiers to request the Governor-General on behalf of their respective provinces, to delete the section from the Act.

REFERENCE FROM COMMISSIONER'S ORDER REJECTING APPLICATION FOR REVISION: A SPECIAL BENCH RULING.

A Special Bench of five Judges of the Madras High Court (Sir Lionel Leach, C. J., Madhavan Nair, Varadachariar, Venkataramana Rao, and Abdur Rahman, JJ.) have pronounced a Judgment on the 10th November 1938, which entirely upsets our current notions with regard to the competency of references to the High Court from orders passed by Commissioners in revision under Section 33 of the Indian Income Tax Act. Section 66 (2) of the Act provides that a reference may be made on questions of law arising out of an order under Section 33 enhancing the assessment or 'otherwise prejudicial' to the assessee, and ever since the Income Tax Act was passed the words "order prejudicial to him" have been understood by the department and the public as meaning an order which puts the assessee in a worse position. The section was so interpreted in *N. A. S. V. Venkatachalam Chettiar's Case* (1935 I. T. R. 55). In that case SIR H. O. C. BEASLEY, C. J., said: "What Section 33 clearly contemplates is an order by the Commissioner which alters the position of an assessee or an applicant to that person's prejudice". Where a Commissioner's order does no more than leave him in the position at which he was placed by the order sought to be revised the order is not an order 'prejudicial to him'. It is only if his position is altered to his prejudice that the Commissioner's order can be said to be prejudicial to him within the meaning of Section 66 (2). This case was followed in several subsequent decisions, of which we may mention *Adam Hajee Dawood's Case* (1936 I.T.R. 100) and *Central India Company v. Commissioner of Income-tax* (1937 I. T. R. 267). In the latter case SIR GILBERT STONE, C.J., after referring to *Venkatachalam Chettiar's Case* and discussing the provisions of Sections 33 and 66 (2) of the Income Tax Act, said that he respectfully agreed with the conclusion arrived at in *Venkatachalam Chettiar's Case*.

The question whether *Venkatachalam Chettiar's Case* was correctly decided was referred to the Special Bench and that case has now been overruled. Their Lordships say that they are

unable to accept the interpretation put upon Section 66 (2) in *Venkatachalam Chettiar's Case*. In the opinion of the Special Bench, in order that an order may be prejudicial to the assessee within the meaning of Section 66 (2) it need not be more prejudicial than the order sought to be revised. The section does not say so. All that it contemplates is a prejudicial order and in their Lordships' view if an order of an Income Tax Officer is prejudicial, an order which confirmed it, or rejected the application for revising it, would also be prejudicial within the meaning of Section 66 (2). Their Lordships refer to the fact that a decree of an appellate Court dismissing an appeal from a Court of first instance could not be said to be not prejudicial to the appellant. It is as prejudicial as the first decree. There is no difference in this respect between the dismissal of an appeal and the dismissal of an application for revision, when the law permits such an application to be made. In their Lordships' opinion an order which dismissed an application for the revision of a prejudicial order must be deemed to be prejudicial with the meaning of Section 66 (2).

IS THIS DECISION SOUND ?

The judgment of the Madras High Court is no doubt one pronounced by a Special Bench of five Judges who specially sat for the purpose of considering the question in issue and is therefore, of great weight as an authority. But with all respect to their Lordships, we prefer the view taken in *Venkatachalam Chettiar's Case* which their Lordships have now overruled. We think that the scheme of Income Tax Act and the provisions relating to appeals and revision contemplate that a reference should lie from an order in revision passed by the Commissioner only in cases where such an order alters the position of the assessee to his prejudice. We are clearly of opinion that an order which merely rejects an application by an assessee to the Commissioner to exercise his powers under Section 33 in his favour, is not an order under Section 33 enhancing an assessment or otherwise prejudicial to him within the meaning of Section 66 (2).

The question is, on the face of it, a very important one to assesseees as well as the department and we are awaiting with great interest and anxiety what the other High Courts have to say. The point will continue to be an important one even after the new Amendment Bill is passed, as the Bill does not in any way propose to alter the Act in this respect.

REFUND OF TAX UNDER INDIA AND BURMA (INCOME TAX RELIEF) ORDER, 1936 : AMENDMENT OF INCOME-TAX RULES.

By an order of His Majesty in Council entitled The India and Burma (Income-Tax Relief) Order 1936 special provision was made for the grant of relief from tax where the same income is taxed or taxable both in India and Burma. The full text of the Order is published in *1937 Income Tax Reports*. The Central Board of Revenue have recently amended the Income Tax Rules by the addition of two new Rules (Rules 40-A and 40-B) which provide the forms of applications for refund and appeals therefrom. The text of the notification of the Central Board of Revenue with the forms is published in the Gazette of India dated 29th October 1938 at pp. 1787 ff. and runs as follows :—

“In exercise of the powers conferred by Sub-section (1) of Section 59 of the Indian Income-tax Act, 1922 (XI of 1922), read with paragraph 5 of Part II of the India and Burma (Income-tax Relief) Order, 1936, the Central Board of Revenue directs that the following further amendment shall be made in the Indian Income-tax Rules, 1922, the same having been previously published as required by Sub-section (4) of the said section, namely :—

After rule 40 of the said Rules, the following rules shall be inserted, namely :—

“40-A. An application for refund of income-tax under the India and Burma (Income-tax Relief) Order, 1936, shall be made in the following form :

Application for relief from double/triple income-tax under the India and Burma (Income-tax Relief) Order, 1936.

I of , do hereby state that I have paid (1) Burma Income-tax/income-tax and super-tax amounting to
Burma Income-tax/income-tax and super-tax and United Kingdom
Rs.
income-tax/income-tax and super-tax amounting to Rs. and £
for the year ending 31st March 19 on an income (2) of
ended
Rs.
Rs. and £ respectively and that Indian Income-tax/income tax and
 super-tax of Rs. has also been paid on the same income
 part of the same income amounting to Rs. I am therefore

entitled to relief under the provisions of the India and Burma (Income-tax Relief) Order, 1936, at the rate of (1) (I have obtained relief under the provisions of 'Section 27 of the English Finance Act 1920 at the rate of see attached certificate from the Inspector of Taxes.)

I now pray for relief amounting to Rs. under the India and Burma (Income-tax Relief), Order, 1936. My income from all sources to which the Income-tax Act, 1922, applies during the previous year ending on the 19 , amounted to Rs. only—see Return of income attached/already submitted. I attach the Official receipt of the Burma income tax paid and the notice of assessment, showing the basis on which the liability has been computed ((3) as also copies of the appellate order of the Assistant Commissioner and of the order on revision by the Commissioner).

Signature.

I hereby declare that what is stated herein is correct. (4) I further declare that as regards my Burma assessment, I have no intention to appeal to the Assistant Commissioner or to approach the Commissioner to revise it.

Signature.

Dated

19

40-B. An appeal under the India and Burma (Income-tax Relief) Order, 1936, shall be in the following form :

Form of appeal against an order refusing to grant a refund under the India and Burma (Income-tax Relief) Order, 1936.

To

The Assistant Commissioner of

The

day of

19

The petition of

of

post office

THE INCOME TAX REPORTS

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[IN THE ALLAHABAD HIGH COURT].

MAHAMMAD FARUQ, *In re.*

NAIAMATULLAH, J., and ALLSOP, J.

August 26, 1937.

CASUAL AND NON-RECURRING RECEIPT—EMPLOYEE DISPOSING OF SHARES OF LIMITED COMPANY TO WHICH EMPLOYER SELLS HIS BUSINESS—ALLOTMENT OF SHARES TO EMPLOYEE IN RECOGNITION OF SERVICE—NOT LEGALLY ENFORCEABLE CLAIM—ALLOTMENT, WHETHER AMOUNTS TO 'INCOME'—'BUSINESS', MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 4 (3) (vii).

The assessee was the employee of one S, who owned a sugar factory. S decided to transfer the factory to a new limited company. The assessee disposed of a large number of shares in the company and the directors of the company, in recognition of the assessee's services, allotted to him shares to the value of Rs. 15,000. The Commissioner of Income-tax found that the payment on the part of the directors was voluntary and without any previous agreement or understanding. The applicant was not carrying on the vocation of a promoter of companies or share broker: Held, on a reference by the Commissioner, that the allotment of shares did not amount to 'income' assessable under the law, but was in the nature of a wind-fall, and was therefore exempt from assessment. Held also, that 'business' must be some activity which has for its object the acquirement of some profit which can be claimed as of legal right and the activities of the assessee could not be described as business.

Cases referred to :

GAYAPRASAD CHOTEY LAL, *In re* [1935] (1935 I.T.R. 177; 1935 A. L. J. 405; 8 I. T. C. 64; A. I. R. 1936 All. 495) *distinguished*.

SHAW WALLACE & CO.'S CASE [1932] (30 A.L.J. 988; 59 I.A. 206; 136 I.C. 742; 6 I.T.C. 178; A.I.R. 1932 P.C. 138; 1932 Comp. Cas. 276 P.C.) *referred to*.

Case stated by the Commissioner of Income Tax, U. P. and C. P. under Sec. 66 (2) of the Indian Income Tax Act. (Mis. Case No. 729 of 1935).

STATEMENT OF CASE.

" Case stated by the Commissioner of Income-tax, Central and United Provinces, under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as the Act), at the instance of Mr. Mohammad Farooq, M. Sc., of Gorakpur, an individual within the meaning of Sec. 3 of the Act (hereinafter referred to as the assessee) for the decision by the Hon'ble the High Court of Judicature at Allahabad, of the question of law set out in paragraph 8 of this statement, arising out of the Assistant Commissioner's order under Sec. 31 in appeal against the assessee's assessment for the year 1933-34 (hereinafter referred to as the assessment in dispute).

Facts of the case.—The assessee was formerly a professor of mathematics in the Aligarh University. He retired from service in April or May, 1930. Six months after his retirement he accepted the office of a Manager of what is known as the Mian Lahib or the Imambara Estate in the Gorakpur District on a salary of Rs. 400 a month. He was accordingly assessed on his income from salary and the notional value of the rent-free quarters which he occupied in the assessment year 1931-32. In 1932-33 he filed no return and the salary income was assessed in the same manner under Sec. 23 (4). For the year in dispute he was originally assessed in the amount of Rs. 690. The assessment was made on 26th January, 1933. Subsequently on an examination of the Articles of Association of the Pipraich Sugar Mills Co., Ltd., the Income-tax Officer found that the company had allotted to the assessee fully paid up shares of the nominal value of Rs. 15,000 in lieu of the services rendered by him in the promotion of the Company. The Income-tax Officer accordingly served on him a notice under Sec. 24 read with Sec. 22 (2). In compliance with the notice, the assessee submitted on 23rd May 1934 a revised return including the value of the shares. The Income-tax Officer

accepted the return and levied an assessment under Sec. 23 (1) in the total amount of Rs. 19,690. A copy of the Income-tax Officer's order is in Appendix A. Subsequently the assessee appealed contending that the paid up shares were a windfall and their value was exempt under Sec. 4 (3) (vii). The Assistant Commissioner found as a matter of fact that the assessee was in the employ of one Syed Jawad Ali Shah who had erected a Sugar Mill at Pipraich. This mill was later made over to a company of limited liability in which the founder Syed Jawad Ali Shah was the principal share-holder. The assessee having successfully canvassed for the promotion of the Company, the Directors decided, apparently at the instance of Syed Jawad Ali Shah, to allot and did allot to him fully paid up shares of the aforesaid value in lieu of his services rendered in promoting the Company. The Assistant Commissioner accordingly dismissed the appeal, holding that the shares did not represent a windfall but remuneration for services rendered and the exemption under Sec. 4 (3) (vii) did not apply. A copy of his order will be found in Appendix B. The assessee was not satisfied with it. He has therefore, filed an application (Appendix C) for a reference under Sec. 66 (2) of the Act.

3. Question for the decision of the Hon'ble the High Court framed by the assessee:—"Whether the fully paid up shares of Rs. 15,000 allotted to the applicant in service of one of the shares only by the Directors of the Pipraich Sugar Factory, Limited under the circumstances mentioned above, i.e., voluntary and without any previous agreement or understanding, amount to an income assessable under law or are mere receipts of a casual and non-recurring nature, within the meaning of Sec. 4 (3) (vii) and exempt from assessment."

There is no dispute as regards the facts embodied in the above question and I refer it in the form in which the assessee has framed it.

4. **Opinion of the Commissioner.**—In order to claim the benefit of Section 4 (3) (vii) of the Indian Income-tax Act, it is necessary that the receipts in question should be not only non-recurring but also casual. In this case it is not denied that the receipts in question were non-recurring. But that is not enough. In my opinion they cannot be said to have been casual because they were the direct result of definite efforts made by the assessee in connexion with the promotion of the company on behalf of his employer, who was the person who secured the grant to the assessee of the issue of fully paid up

shares. Remuneration for such efforts cannot be said to be casual in nature in the same way as is the winning of prize in a lottery or the receipt of a gift *inter vivos*. The circumstances of the case make it a fair inference that the assessee did not engage in these efforts with no expectation of receiving anything in return, and I agree with the remark of the Assistant Commissioner that even if there was no cut and dried agreement between the employer and the employee regarding the remuneration for the services rendered, the latter must have been well aware that he would be suitably recompensed for his labours, although as to the actual amount he had to trust to the good sense of the directors. For these reasons I cannot admit that the receipt was of a casual nature. If it should be contended before the Hon'ble Court that the assessee's case rests not so much upon the wording of Section 4 (3) (vii) of the Act as upon the claim that the payment was not "income" at all, I have no doubt, even allowing for all differences in detail, that the Hon'ble Court will agree that the claim must be rejected for reasons comparable to those which prevailed with it in reaching its judgment dated the 30th of November 1934, in the case of *Messrs. Gaya Prasad Ohhotey Lal of Mahashari Mahal, Cawnpore City*.

5. As required by rule 7 of the rules framed by the High Court a relevant portion of the statement of the case was sent to the assessee for observations and suggestions if any. A copy of his reply will be found in Appendix D. The words used by me follow as an obvious inference from the relationship of a servant the assessee bore to Syed Jawad Ali Shah and are therefore relevant."

JUDGMENT.

COLLISTER, J.—Under the provisions of Sec. 66 (2) of the Indian Income-tax Act the Commissioner of Income-tax has referred to us the following question of law :—

"Whether the fully paid up shares of Rs. 15,000 allotted to the applicant in service of one of the shares only by the Directors of the Pipraich Sugar Factory Ltd., under the circumstances mentioned above, *i.e.*, voluntarily and without any previous agreement or understanding, amount to an income assessable under law or are mere receipts of a casual and non-recurring nature within the meaning of Sec. 4 (3) (vii) and exempt from assessment".

The applicant was employed by Syed Jawad Ali Shah as the manager of the Main Sahib of Imambara State in the Gorakhpur district on a salary of Rs. 400 a month. Syed Jawad Ali Shah established a sugar factory on this estate. He afterwards decided

to transfer the factory to a limited company. The Pipraich Sugar Factory Ltd., was established in order to take over the concern. The applicant took a great deal of trouble in disposing of the shares of the company, i.e., in inducing a number of people to invest their capital in the company. After the company had been successfully floated, the Directors, in recognition of the applicant's services, allotted to him shares to the value of Rs. 15,000. The applicant had been assessed to income-tax in previous years on his salary. In the year with which we are concerned he was originally assessed upon the same basis, but after the assessment had been made the Income-tax Officer discovered from the Articles of Association of the Pipraich Sugar Factory Ltd., that this allotment of shares to the value of Rs. 15,000 had been made in favour of the applicant. He then issued a notice to the applicant to submit a revised return. The applicant thereupon did submit a return in which he included this sum of Rs. 15,000 as part of his income. It is obvious, however, that he never intended to admit that this sum was income assessable to tax. The Income-tax Officer decided that it was so assessable and made an assessment accordingly. The applicant appealed to the Assistant Commissioner of Income-tax but his appeal was dismissed. He then made an application to the Income-tax Commissioner with the result that we have this reference before us.

In the course of the argument learned Counsel appearing for the Income-tax Department pointed out that the Assistant Commissioner of Income-tax in his order had said that the payment could not be considered as an *ex gratia* one. The Assistant Commissioner said: "Even, if there was no cut and dried agreement between the employer and the employee regarding the remuneration for services rendered, still the latter must have been well aware that he would be suitably recompensed for his labours, although as to the actual amount he had to trust to the good sense of the directors". It seems to us that the learned Assistant Commissioner intended to find that there was no definite contract which could be enforced and therefore in that sense the payment was a matter of grace on the part of the directors, but that question is of no importance because we have to deal with the question of law which has been stated and the Income-tax Commissioner has asked for our opinion upon the assumption that the payment on the part of the directors was voluntary and without any previous agreement or understanding.

Learned Counsel for the Income-tax Department has also argued that the reference really raises two independent questions of law, *viz.*, (1) whether this allotment of shares amounts to income within the meaning of the Act and (2) whether, if it amounts to income, it is income which is exempted within the meaning of Section 4 (3) (vii) of the Act, *i.e.*, whether it was receipt, not being a receipt arising from business or the exercise of a profession, vocation or occupation which is of a casual and non-recurring nature and is not by way of addition to the remuneration of an employee. We do not think that the two questions can be considered as entirely separate and independent.

In the case of the *Commissioner of Income-tax, Bengal v. Shaw Wallace and Company* their Lordships of the Privy Council said:—

“Some reliance has been placed in argument upon Sec. 4 (3) (v) which appears to suggest that the word ‘income’ in this Act may have a wider significance than would ordinarily be attributed to it. The sub-sections say that the Act ‘shall not apply to the following classes of income’ and in the category that follows, clause (v) runs:—‘Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber or to any such Provident Fund’. Their Lordships do not think that any of those sums, apart from their exemption, could be regarded in any scheme of taxation as income, and they think that the clause must be due to the over anxiety of the draftsman to make this clear beyond possibility of doubt. They cannot construe it as enlarging the word ‘income’ so as to include receipts of any kind which are not specially exempted”.

The result is that a receipt may not be income within the proper connotation of that term and yet may come within the exceptions in Sec. 4 (3) of the Act. We must decide whether this allotment of shares is income assessable under the Act after considering all the circumstances and applying not only the ordinary meaning of the word ‘income’ but also the terms of the relevant part of Sec. 4 (3) of the Act.

Their Lordships in the case to which we have referred pointed out that the word ‘income’ was not defined anywhere in the Act. They said:—“Income, their Lordships think, in this Act connotes a periodical monetary return ‘coming in’ with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously

productive but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall ”.

We have to see whether the allotment of shares is income within the meaning which has been assigned to that term by their Lordships of the Privy Council or whether it can be described as a mere windfall. We do not think there can really be any doubt upon this question. The applicant was not an employee of the Pipraich Sugar Factory Limited, although it appears from the reference that his employer, Syed Jawad Ali Shah, was one of the shareholders in the company. This payment was not made by the Company to one of its employees for services rendered. The applicant was not in any way carrying on the vocation of a promoter of companies or a share-broker or anything of that kind. He did not enter into any contract with the company by which the Company promised him remuneration for assisting in the disposal of shares. It may be that the applicant was actuated by a hope that his services if successful would not go unrequited but it is obvious that he had no legal claim against the company and that any hope that he had was based upon the grace and goodwill of the Directors. It cannot be said that the applicant's object was the production of any definite return. If he hoped for a return that return was certainly not definite in its nature. He may have been actuated by a desire merely to assist his employer in disposing of Factory hoping thereby to secure his employer's good-will and gratitude. We do not think that the applicant's activities can be described as business which is stated in the Act to include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. We think that business must be some activity which has for its object the acquirement of some profit which can be claimed as of legal right. The receipt of the shares in this case was certainly in the nature of a windfall. The receipt was certainly casual in its nature. There was no expectation of returns which would come in with any sort of regularity.

We are aware of the decision of this Court in the case of *Gaya Prasad Chotey Lal* but that was a case which was decided upon its own facts. We must not be understood to say that a single transaction of a business nature, such for instance as a money-lending transaction which resulted in gain would not justify the assessment of income upon that gain, but a transaction of that kind would clearly come within the meaning of the term 'business' and consequently it would not matter whether it was or was not

of a casual and non-recurring nature. The facts of the case before us are entirely different. Applying the meaning assigned by their Lordships of the Privy Council to the term 'income' and applying also the provisions of Sec. 4 (3) (vii) of the Act we are satisfied that this receipt of the shares in the company was not income assessable under the Act.

Our answer to the reference is that the allotment of shares did not amount to income assessable under the law and that the receipt was exempt from assessment. The assessee's costs shall be paid by the Department. We assess the fee of the Counsel for Income-tax Department at Rs. 150. A certificate shall be filed within six weeks.

Reference answered accordingly.

[IN THE MADRAS HIGH COURT.]

COMMISSIONER OF INCOME TAX, MADRAS

v.

S. L. MATHIAS.

LEACH, C. J., VARADACHARIAR, J., and KING, J.

October 18, 1937.

APPEAL TO PRIVY COUNCIL—'SUBSTANTIAL QUESTION OF LAW'
—TAX INVOLVED LESS THAN RS. 10,000—POWER TO GRANT
LEAVE—COSTS—HIGH COURT HAS NO POWER TO IMPOSE CONDI-
TION THAT APPELLANT SHALL BEAR COSTS OF APPEAL TO PRIVY
COUNCIL—INDIAN INCOME TAX (XI of 1922), Sec. 66-A.

The High Court has no power on granting leave to appeal to the Privy Council in an income-tax case to impose a condition that the appellant should bear the costs of the appeal.

Where the amount of income-tax in question in an application for leave to appeal to the Privy Council was only Rs. 3,500 and it was contended on behalf of the assessee that, as the amount involved was less than Rs. 10,000 leave should not be granted but it appeared that the question would arise in successive years so long as the assessee carried on his business and there was also a substantial question of law to be decided, the High Court granted leave to appeal.

Case referred to :

RAJARAJESWARA SETHUPATHI *v.* TIRUNRELA KANTAM SERVAI
[1928] (44 M.L.J. 217; A.I.R. 1928 Mad. 232; 72 I.C. 250),

Petition for leave to appeal to the Privy Council from the Judgment of the Madras High Court in O. P. No. 181 of 1936 reported as *Commissioner of Income-tax, Madras v. S. L. Mathias* (1937 Income Tax Reports, p. 435).

M. Patanjali Sastri for the Commissioner of Income-tax.

M. Subbaraya Aiyar, for the Assessee.

JUDGMENT.

LEACH, C. J.—The Commissioner of Income-tax applies for a certificate permitting him to appeal to His Majesty in Council in respect of a decision of this Court on the effect of the second proviso to Sec. 4 (2) of the Indian Income-tax Act. There can be no doubt that the question involved is a substantial question of law. As a matter of fact this Court placed a different interpretation on the proviso from that placed upon it by the Calcutta High Court.

The application is, however, opposed by the respondent on the ground that an appeal to His Majesty in Council would put him to considerable expense. He contends that if leave is granted it should be subject to the condition that the income tax authorities pay his costs. It is quite clear that we have no power to impose any such condition and this was pointed out by this Court in the case of *Rajarajeswari Sethupathi v. Tiruneelakantam Servai* (44 M.L.J. 217). Our powers are confined in this respect to those conferred by Sec. 66-A of the Income-tax Act and the provisions of the Code of Civil Procedure, which have been made applicable to such appeals. Their Lordships of the Privy Council have on occasions, stipulated in granting special leave to appeal that the appellant shall bear the costs. But we have no such powers, as I have already indicated. When the appeal is heard in the Privy Council their Lordships will then decide the question of costs.

The learned Advocate for the respondent also says that leave should not be granted because the amount involved is less than Rs. 10,000. The actual amount of the tax in question is Rs. 3,500. But the respondent carries on as a planter a large business in the Mysore State and the question will arise each year while he remains in this business. Therefore, in the end the amount of tax will be very considerable. The learned Advocate has in this connection referred to the decision in *Rajarajeswari Sethupathi v. Tiruneelakantam Servai*, as the Court there refused leave to appeal to His Majesty. That was a case in which the petitioner was wishing to challenge a decision in respect of arrears of rent. There was a large number of respondents, but in each case the amount

owed or alleged to be owed was very small. The decision does not apply to the present case because the amount involved, as I have indicated, is really substantial. The application for a certificate will therefore, be granted.

Leave granted.

[IN THE NAGPUR HIGH COURT]

COMMISSIONER OF INCOME TAX, C. P. & U. P.

v.

MOTIRAM NANDRAM.

Sep. 30, 1935 ; Nov. 6, 1936.

SUBHEDAR, POLLOCK, and GRUER, A. J. Cs.

September 1, 1937.

POLLOCK and DIGBY, JJ.

LOSS—CAPITAL LOSS AND TRADING LOSS—ASSEESSEE ADVANCING MONEY ON INTEREST FOR SECURING ORGANISING AGENCY OF OIL COMPANY—ADVANCE REPAYABLE WITH INTEREST OUT OF DEPOSITS OF SELLING AGENTS RECOMMENDED BY ASSESSEE—ASSEESSEE ENTITLED TO COMMISSION ON ALL SALES EFFECTED BY COMPANY—ADVANCE, WHETHER LOAN OR INVESTMENT OF CAPITAL TO ACQUIRE BUSINESS—LOSS OF ADVANCE, WHETHER TRADING LOSS OR CAPITAL LOSS—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 10 (2) (ix).

The assessee carried on business in cloth, yarn and money-lending. In 1930 they deposited with an oil company Rs. 5,000 in consideration of an agreement which, inter alia, provided as follows : The assesseees were appointed Organising Agents of the oil company for 5 years for a particular area. They were to recommend selling agents. Sales were to be conducted entirely by the company and the selling agents, but the assesseees were to receive a certain commission on all goods sold by selling agents within the area, and also on all sales of oil effected in the area by the company. The deposit was to remain at the disposal of the company for the purpose of the company's business, and was to carry an interest of 7 per cent. per annum, until it was repaid out of the deposits made by the selling agents. After the assesseees had recovered a part of the deposit, the company went into liquidation and though the assesseees obtained a decree for Rs. 39,500 against the company they were unable to realise this

amount, and they therefore claimed in the year 1932-33 that this amount should be deducted from their other income as a loss in business. On a reference by the Commissioner :

Held, *per* SUBHEDAR, A.J.C., and GRUBB, A.J.C., (POLLOCK, A.J.C., dissenting)—*that the deposit made by the assesseees was in the nature of a loan made by the assesseees in the course of their money-lending business out of their floating or circulating capital and the loss incurred was therefore allowable as a trading loss in computing their income.*

Per POLLOCK, A.J.C.—*The deposit was money invested in acquiring a new business, it was not a loan made in the course of the assesseees' money-lending business nor money laid out in the ordinary course of an existing business, and, being in the nature of a capital expenditure, could not be deducted in computing the assesseees' income.*

Cases referred to—

ATHERTON *v.* BRITISH INSULATED CABLES, LTD. [1925] (10 Tax Cas. 155; 1926 A.C. 205; 95 L.J.K.B. 336; 42 T.L.R. 187).

BOARD OF REVENUE *v.* ARUNACHALAM CHETTIAR [1923] (I.L.R. 47 Mad. 197; 1 I.T.C. 238.)

CHARLES MARSDEN AND SONS *v.* COMMISSIONERS OF INLAND REVENUE [1919] (12 Tax Cas. 217).

CHETTIAPPA CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1930] (A.I.R. 1930 Mad. 119; 122 I.C. 349; 4 I.T.C. 188).

CITY OF LONDON CONTRACT CORPORATION LTD. *v.* STYLES [1887] (2 Tax Cas. 239; 4 T.L.R. 51).

"COUNTESS WARWICK" STEAMSHIP CO. LTD. *v.* OGG. [1924] (8 Tax Cas. 652; 1924, 2 K.B. 292; 93 L.J.K.B. 736; 131 L.T. 348).

COMMISSIONER OF INCOME TAX, MADRAS *v.* A. S. CHETTY [1928] (A.I.R. 1928 Mad. 902; 110 I.C. 629; 3 I.T.C. 44).

COMMISSIONERS OF INLAND REVENUE *v.* GRANITE CITY STEAMSHIP Co., [1927] (6 A.T.C. 678; 1927 Ses. Cas. 705; 13 Tax Cas. 1).

JOHN SMITH & SON *v.* MOORE [1921] (2 A.C. 18; 12 Tax Cas. 266; 90 L.J.P.C. 149; 125 L.T. 481).

KANGRA VALLEY SLATE CO. LTD., *v.* COMMISSIONER OF INCOME TAX, MADRAS [1935] (7 I.T.C. 375; I.L.R. 16 Lah. 479; 1935 I.T.R. 324; 87 P.L.R. 749).

LAKSHMANAN CHETTIAR *v.* COMMISSIONER OF INCOME TAX, MADRAS [1930] (58 M.L.J. 68; A.I.R. 1930 Mad. 121; 124 I.C. 151; 4 I.T.C. 200).

Case stated by the Commissioner of Income Tax, C. P. and U. P. under Sec. 66 (2) of the Indian Income-tax Act (XI of 1922).

STATEMENT OF THE CASE.

“ Indian Income-tax Act, 1922, Sec. 66 (2)—Reference in the matter of Messrs. Motiram Nandram of Hinganghat.

Case stated at the instance of Messrs. Motiram Nandram of Hinganghat, District Wardha, a Hindu undivided family (hereinafter referred to as the assessee) by the Commissioner of Income-tax, Central and United Provinces, under Section 66 (2) of the Income-tax Act (hereinafter referred to as the Act) for the decision of the Hon'ble the High Court of Judicature at Nagpur of the questions of law set out in paragraph 3 of this statement, arising out of the appellate decision under Sec. 31 of the Act of the Assistant Commissioner of Income-tax, Jubbulpore, against the assessment to income-tax for the year 1933-34.

2. **Facts of the Case.**—The assessee carries on cloth, yarn and money-lending business. For the assessment year mentioned above the Income-tax Officer, Wardha, assessed it in the amount of Rs. 20,407 to income-tax amounting to Rs. 1,666-12-0 and surcharge thereon amounting to Rs. 416-11-0. The assessee had deposited a sum of Rs. 50,000 with the Kerosena and Mineral Oil Company of Bombay (hereinafter referred to as the Company) under an agreement dated December 17, 1930 (Appendix A). After it had recovered a part of the money the company went into liquidation. The assessee sued the company and obtained a decree for Rs. 32,500 but was unable to recover the amount. It accordingly claimed it as a bad debt but the Income-tax Officer disallowed it on the ground that the amount deposited was in the nature of a security deposit and that the loss arising out of it was a loss of capital and not a trading loss such as could be allowed by way of a bad debt. Relevant extract from the assessment order will be found in Appendix B. The assessee appealed contending (1) that the deposit was made in the regular course of its money-lending business, (2) that it represented money laid out for business purposes with a view to earn increased profits, (3) that it was in the nature of a loan to the Company which had agreed to pay interest at a specified rate, (4) that in any case it was an advance against the cost of goods to be supplied by the Company through it as an Organising Agent to the selling agents whose fidelity the assessee had guaranteed to the Company and (5) that therefore the amount should be allowed as a bad debt arising out of the agreement as a

business transaction. Upon a consideration of the various clauses of the agreement the Assistant Commissioner held that the deposit was neither a loan nor an advance against the cost of goods and that it did not represent money laid out in the course of business but was, as held by the Income-tax Officer, purely a security deposit the object of which was to finance the Company and to secure and acquire a new business or a new source of income. He, therefore, disallowed the contentions. A copy of the relevant extract from his appellate order is in Appendix C. The assessee has now applied for a reference to the Hon'ble the High Court on the questions said to be questions of law propounded by it in the petition under Sec. 66 (2) (Appendix D.) As I agree with the reasons given by the Assistant Commissioner, I am unable to give the assessee the relief it desires.

3. Question for the Decision of the Hon'ble the High Court.—The four questions framed by the assessee are really different arguments for the same point and it will be enough, in my opinion if your Lordships decided the following question only. In the event of the decision being in the negative it will enable me to give the assessee all the relief sought for by it :

“Having regard to the terms of the agreement (Ex. A) and the other circumstances of the case, was the Assistant Commissioner justified in holding that the item of Rs. 32,500 was not a trading loss but a loss of capital ?”

4. Opinion of the Commissioner.—For the many reasons given by the Assistant Commissioner I am of the opinion that the question should be answered in the affirmative.

[The reasons given by the Assistant Commissioner which are adopted by the Commissioner appear in the following passage extracted from the Assistant Commissioner's order :—

“Upon a consideration of the terms of the agreement dated the 17th December 1930 I am clearly of opinion that the deposit was neither a loan nor an advance towards the cost of goods, nor did it represent money laid out for business, but that it was merely a security deposit, the object of which was to finance the company and to secure *and acquire a new business* or a new source of income.

According to article 4 of the agreement the petitioners were appointed organising agents with a power of attorney (article 6) in consideration of the deposit, and the mere fact the company agreed to pay interest would not convert it into a money-lending

transaction. Under articles 4 and 5 the deposit was to "remain at the disposal of the Company" and the company was entitled "to use the said deposit for the purposes of the company's business". That the deposit was also not by way of an advance towards future supplies is made abundantly clear by the terms of article 13, which says that "the organising agents shall not effect any sales of the company's kerosene and motor spirit themselves". These provisions in the agreement clearly show that the deposit was made with a twofold object, firstly to acquire the organising agency as a new business, and secondly to give an assurance to the company regarding the petitioner's good faith and business standing, in a word, as a security of their honesty and capacity to organise the company's business and as a guarantee for the payment of the price of goods supplied to the selling agents.

4. Stress is however, laid on the fact that the petitioners were entitled to receive back the deposit money as and when deposits came in from the selling agents and on the condition in article 9 which says that "the company shall not be bound to meet any indents to such extent as are not covered by the security deposits of the selling agents unless the organising agents pay to the company such further deposits as may be required to cover the excess". But upon a proper interpretation this term simply means that the deposit, whether made by the selling agents or by the organising agents, was as already stated merely by way of security for the payment of price of goods supplied and is not to be treated as an advance. The Company was entitled to hold the amount as a deposit *for all times* as a security for the payment of the price of goods that might be supplied by it from time to time to the selling agents. The price of the goods was to be paid independently of and in addition to the deposit and it cannot, therefore, be treated as an advance against goods. In this connection I may refer to the discussion at pages 564-567 of the 3rd Edition of the *Law of Income-tax in India by Sundaram*. I, therefore, hold that the deposit was money invested for the purpose of acquiring a new business; that it was merely a security deposit in the above sense; that it was not a loan as part of the petitioners' money-lending business nor money laid out in the ordinary course of business of an *existing business*, nor even an advance against goods or stock-in-trade to be supplied by the company; that it was nothing but a capital investment and that the loss is not deductible either as a bad debt or a trade loss. The objection is therefore overruled.

The case was heard by Subhedar and Pollock, A. J. C's., who disagreed and delivered the following opinions on 30th September 1935.

D. N. Choudri, for the Commissioner.

JUDGMENT.

SUBHEDAR, A. J. C.—This is a reference under Sec. 66 (2) of the Indian Income-tax Act (XI of 1922), by the Commissioner of Income-tax, Central and United Provinces, in the matter of the assessment of the income of Messrs. Motiram Nandram (hereinafter called the assessee) carrying on cloth, yarn and money-lending business at Hinganghat. In the return of the income for the purpose of assessment for the year 1933-34 the assessee claimed a deduction of the sum of Rs. 39,500 from their taxable income as a loss in business under the following circumstances. In consideration of securing the Organising Agency of the White Kerosene and Meneral Oil Company of Bombay (hereinafter called the Company) the assessee had deposited with the Company Rs. 50,000 on terms embodied in an agreement dated the 17th December 1930 (Appendix A). The aforesaid deposit was to be used by the Company in their business, but was repayable to the assessee with interest at 7 per cent per annum out of the deposits which were to be made by the "Selling Agents" with the company to cover the price of oil to be supplied to them by the Company for sale. Besides the return of the aforesaid deposit with interest the Company had further agreed to pay to the assessee all the expenses incidental to the organisation and carrying on of the Agency business and also a commission, on the value of the goods sold by the "Selling Agents", by way of remuneration. The Company however went into liquidation before the assessee could recoup the deposit. They accordingly filed a suit in the High Court of Bombay against the proprietors of the Company and the Official Assignee and obtained a decree for Rs. 42,272-2-0 and costs, but as the decretal amount could not be fully recovered, the irrecoverable balance of Rs. 39,500 was written off by the assessee as a bad debt.

2. The Income-tax Officer disallowed the claim of the assessee for the following reasons:—

"The whole transaction is a mere investment of capital by way of security. It is not a money-lending loan advanced. It carried interest at 7 per cent. as it was a mere deposit for security, which every oil company agent had to do. Assessee's money-

lending to debtors carries interest ranging from 15 per cent. to 25 per cent. Thus the alleged bad debt is a mere capital loss and is disallowed".

3. This order was upheld by the Assistant Commissioner on appeal, though on somewhat different grounds. The Assistant Commissioner held "that the deposit was neither a loan nor an advance towards the cost of goods, nor did it represent money laid out for business, but that it was merely a security deposit, the object of which was to finance the Company and to secure *and acquire a new business or a new source of income*".

4. Although four definite questions were raised by the assessee in their application for reference, the learned Commissioner, being of the opinion that all the questions were really different arguments for the same point, has referred the following question only for the decision of this court:—

"Having regard to the terms of the agreement (Ex. A) and the other circumstances of the case, was the Assistant Commissioner justified in holding that the item of Rs. 89,500 was not a trading loss but a loss of capital?"

5. On behalf of the Commissioner, *Rai Bahadur Chaudhri* contended, that, as the deposit made by the assessee with the Company was simply an investment of capital for the acquisition of a new business in oil and was neither a loan nor an expenditure incurred solely for the purpose of earning profits in the business already carried on by them, its loss could not be regarded as a trading loss. On the other hand, the learned Counsel for the assessee maintained that although the transaction might not *prima facie* appear to be in the nature of a loan, pure and simple, it clearly represented money laid out wholly in the existing business with a view to earn increased profits. In the alternative it was contended that, on a strict interpretation of the terms of the agreement between the assessee and the Company, under which the deposit was made, it was nothing short of an advance towards the cost of goods to be supplied by the Company to its various "Selling Agents."

6. The question for decision, therefore, simply narrows down to this: was the deposit of Rs. 50,000 made by the assessee with the Company in the nature of a capital investment in a new business of dealing in oil, or was it made in the course of their money-lending business with a view to earn increased profits which the assessee expected to make out of the Organising Agency which they secured from the Company in consideration of making the

aforesaid deposit? The distinction between capital expenditure and revenue expenditure, fixed capital and circulating or floating capital though vital, is indeed so fine that no authority has ever accurately defined these terms. Each reported case, in which the question whether a particular expenditure should go to the capital, or the revenue account, appears to have been decided with reference to its peculiar facts.

7. In the *Commissioners of Inland Revenue v. Granite etc. Steamship Co.* (6 A.T.C. 671) it was observed that "broadly speaking, outlay is deemed to be capital when it is made for the initiation of a business or for a substantial replacement of equipment". In *John Smith and Sons v. Moore* (1921, 2 A.C. 12 at 19) Viscount Haldane made the following observations in this connection:—

"My Lords, it is not necessary to draw an exact line of demarcation between fixed and circulating capital. Since Adam Smith drew the distinction in the Second Book of his *Wealth of Nations*, which appears in the chapter on the Division of Stock, a distinction which has since become classical, economists have never been able to define much more precisely what the line of demarcation is. Adam Smith described fixed capital as what the owner turns to profit by keeping it in his own possession, circulating capital as what he makes profit of by parting with it and letting it change masters. The later capital circulates in this sense".

8. Paragraph 41, Part III, of the Indian Income-tax Manual after describing "irrecoverable loans," states:—"The irrecoverable loans in the sense referred to in this paragraph are sometimes confused with the 'bad debt' described in paragraph 37, but they are of totally different nature. Money lent out on interest is the stock-in-trade of a money lender or banker and loss of such stock-in-trade can clearly be regarded as a trading loss like the loss of the stock-in-trade of any other trader, where the loss is not covered by insurance. In settling claims of this nature the question has always to be considered whether money-lending is or is not a part of the business of the trader in question".

9. It is admitted that the assesseees in the present case carry on business in cloth, yarn and money-lending, the income arising out of which is the subject of assessment. It is also clear from the terms of the agreement entered into between the assesseees and the Company that the assesseees had no concern with the business of purchasing and selling the goods of the Company which was to be conducted solely by the "Selling Agents", who were to be selected

by the assesseees but appointed by the Company : in other words, the assesseees had nothing to do with oil business in which the Company and the " Selling Agents " were alone interested. It therefore follows that the assesseees did not acquire any new business in oil by investing in it the amount of Rs. 50,000 which they deposited with the Company as consideration for securing the Organising Agency.

10. The fourth clause of the agreement definitely provides for the return of the deposit in these terms :

" The said sum of Rs. 50,000 shall remain at the disposal of the company for the purpose of the company's business and shall carry interest at the rate of 7 per cent per annum until the deposit is returned by the Company to the Organising Agents out of the Selling Agents' deposits as hereinafter provided ".

The ' provision ' is to be found in clause 6, which says :—

" The Company hereby authorises the Organising Agents to retain and appropriate selling Agents' deposits to be received by them to the extent only of Rs. 50,000 for the return of their own deposits. All deposits to be received by the Organising Agents from the selling Agents of the Company in excess of the said sum of Rs. 50,000 shall be received by the Organising Agents for and on behalf of the Company and remitted to the Company in Bombay. The Company shall give to the Organising Agents a power of attorney authorising them to receive deposits from the selling Agents of the Company ".

The learned Assistant Commissioner was entirely wrong in finding that " The Company was entitled to hold the amount as deposit *for all times* as a security for the payment of the price of goods that might be supplied by it from time to time to the selling Agents ". There is nothing in the agreement to warrant this finding. The deposits made by the " Selling Agents " were undoubtedly to remain with the company for all times as security for the payment of the price of the goods that might be supplied by it from time to time to the " Selling Agents ".

11. Under clause 10 of the agreement the Company was to provide the Organising Agents with such staff as the Company might deem necessary, at the Company's expense, for the organising Agencies and Depots, and the Company was likewise to provide free office accommodation for a representative of the Organising Agents and a monthly allowance of Rs. 150 for the salary of such a representative. The Company also undertook to defray the railway and other expenses of the Organising Agents incurred in

connection with the business of the Company. By clause 11 the Company further agreed to give to the Organising Agents commission on all sales of goods sold by the Company through the "Selling Agents" at rate specified therein.

12. Although the agreement between the assesseees and the Company may, at first sight, appear to involve two separate transactions, *viz.*, (a) an advance of Rs. 50,000 (termed deposit) by the assesseees to the Company repayable with interest as specified in clauses 4, 5 and 6 of the agreement, and (b) the appointment of the assesseees by the Company as Organising Agents on terms specified in clauses 10 and 11 of the agreement, the transaction is in essence one of money-lending. It would not at all differ, for instance, from an agreement, which the proprietor of a large estate might enter into with a money-lender for borrowing from the latter say one lakh of rupees at 3 per cent per annum rate of interest and agreeing to appoint the money-lender as manager of the estate on a salary of Rs. 300 per month with a stipulation that a certain percentage of the profits of the estate be taken annually in liquidation of the loan.

13. Money which temporarily goes out of a money-lender's hand under an agreement of repayment with interest or other advantages of value, can hardly be regarded as "capital expenditure" in the sense in which the term is ordinarily understood in the administration of the income-tax law. For example, when a money-lending concern takes lands in lieu of debts due and then makes a profit by the sale of those lands, such profit is the profit of the money-lending business, as has been held in *Chettiappa Chettiar v. Commissioner of Income Tax, Madras* (A.I.R. 1930 Madras 119). Similarly in *Lakshmanan Chettiar v. Commissioner of Income Tax* (58 Mad. L.J. 68 F.B.) it was held that the profits obtained by the sale of the rubber plantations taken in liquidation of a debt were not exempt from taxation. Likewise the profits arising out of a money-lender's "exchange business" was treated in *Board of Revenue v. Arunachalam Chettiar* (8 I.L.R. 47 Mad. 197 S.B.) as profits arising out of the business of a money-lender. The following observations of CAVE, L.C., *Atherton v. British etc. Cables* (10 T.C. 155) may usefully be cited in this connection:

"A sum of money expended not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade".

14. It has already been noticed that under the agreement the assesseees acquired no interest whatsoever in the business of the company, namely, that of dealing in oil. It should also be noted that the assesseees did not pay to the Company the amount of Rs. 50,000 absolutely but made a deposit of it on the express condition of its being returned to them with interest and of their being appointed Organising Agents on terms specified in the agreement. The deposit, moreover, was not a "security deposit" as erroneously held by the Income-tax authorities. In my opinion, then, the transaction was nothing short of a loan or debt. In *Stroud's Judicial Dictionary* "Debt" is defined as a sum payable in respect of a liquidatory money demand repayable by action". As a matter of fact, the assesseees did obtain a decree in respect of the balance of their deposit against the insolvent proprietors of the Company and the Official Assignee of Bombay. The assesseees *being money-lenders* by profession, the deposit of Rs. 50,000 on the above terms must therefore be understood to have been made by them in the course of their money-lending business out of their "floating or circulating capital" (stock-in-trade) and not by way of investment of "fixed capital". The fact that the deposit carried the low rate of interest at 7 per cent. per annum only does not at all affect the position, as the transaction was undoubtedly expected to bring in much more profits to the assesseees from the Organising Agency than they normally earned in the shape of interest. That being the position, it follows that the loss in connection with the aforesaid deposit must be held to be a "trading loss" of a money-lender within the meaning of paragraph 41, Part III of the Income-tax Manual.

15. For the foregoing reasons I would answer the question under reference in the negative.

PERLOCK, A.J.C.—I regret that I am unable to agree that the loss on account of the deposit was a trading loss of money-lender within the meaning of paragraph 41 of the Indian Income tax Manual. From the agreement (Appendix A) it appears to me that Rs. 50,000 was advanced by the assesseees to the company in order to secure the appointment of organising agents for 5 years for the area specified. By that agreement the assesseees were to recommend selling agents who would make deposits and work on specified terms, and if they were unable to secure selling agents who were willing to make deposits, they were to recommend persons for appointment as selling agents on a salary basis. The company undertook to pay a commission of 1 per cent on all goods

sold by the company's selling agents within the territory specified, a commission of 4 p̄r case of kerosene, and a commission of 2 as. 6. p. per gallon of motor spirit. This commission was to be divided between the assesses and the selling agents as might be agreed upon between the company, the assesseees and their selling agents. The company further agreed to pay a commission to the assesseees on all sales of fuel oil effected in their territory by the company at the rate of Rs. 2-8-0 per ton and at an enhanced rate of Rs. 5 per ton if the assesseees canvassed the sales, subject to the condition that commission should be Rs. 2-8-0 only on sales to public bodies effected by the assesseees with the previous sanction of the company. The purpose of the agreement was to enable the company to extend its operations over a new area and to give the assessee a share in the profits obtainable in that area.

2. The assesseees were then carrying on a cloth, yarn and money-lending business, and this deposit, which was repayable to the assesseees as it was replaced by the deposits of selling agents, carried interest meanwhile at 7 per cent per annum, but, in my opinion, it was in order to secure the commission and not the interest that the assesseees deposited Rs. 50,000 with the company. The loans advanced to borrowers in the ordinary course of their money-lending business carried interest ranging from 15 to 25 per cent per annum and an offer of 7 per cent per annum would not attract the assesseees. The deposit of Rs. 50,000 appears to have been an investment of surplus capital in a new business rather than a loan in the ordinary money-lending business.

3. Under Sec. 10 (1) of the Indian Income Tax Act the tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him, and under sub-sec. (2) certain deductions may be made. The only deduction with which we are concerned in this case is that contained in clause (ix) which permits the deduction of any expenditure (not being in the nature of capital expenditure) incurred solely for the purposes of earning such profits or gains. The expenditure in this case was, in my opinion in the nature of capital expenditure as it was made not for the purpose of carrying on the business which the assesseees then had but for the purpose of acquiring a new business in oil. In *Commissioner of Income Tax, Madras v. A. S. Chetty* (A.I.R. 1928 Mad. 902), where a contractor bought off a competitor by a payment of Rs. 12,000, it was held that this was expenditure in the nature of capital expenditure, and the principle there laid down, following the decisions in *City of London Con-*

tract Corporation Ltd. v. Styles (2 Tax Cas. 239) *John Smith & Son v. Moore* (2 A. C. 13) and "*Countess of Warwick*" *Steamship Co. v. Ogg* (8 Tax. Cas. 652), was that the money was paid not for the purpose of working of a contract but of getting it, that it was the price that had to be paid to obtain the contract at all, just as in the present case the money was paid in order to secure the appointment of organising agents. Another case which I think is relevant is *Charles Marsden & Sons v. Commissioners of Inland Revenue* (12 Tax Cas. 217) cited at page 566 of *Sundaram's Law of Income-tax in India*, 3rd Edition, as follows.—

"In order to establish a new source of supply, a paper-maker in the United Kingdom advanced money to a wood-pulp manufacturer in Canada, the money bearing interest and being repayable gradually when supplies were made. During the war the British Government stopped the import of wood-pulp and the Canadian firm disclaimed all liability in respect of the advance. *Held*, that the advance was in the nature of capital expenditure".

In that case too it is to be noted that the money advanced was to bear interest and was to be repaid gradually as the supplies were made.

4. I am therefore of opinion that the Assistant Commissioner of Income Tax was correct in holding that the deposit was money invested in acquiring a new business and that it was not a loan made in the course of the assessee's money-lending business, nor money laid out in the ordinary course of an existing business. It was in my opinion an expenditure in the nature of capital and I would therefore answer the question referred to us in the affirmative.

[Owing to this difference of opinion the case was referred to GRUBB, A. J. C., who delivered the following judgment on 6th November 1936.—Ed.]

GRUBB, A.J.C.—This is a case under Sec. 66 (2) of the Indian Income Tax Act, which has been referred to me owing to a difference of opinion of the two learned Additional Judicial Commissioners who heard the reference. The assessees, Messrs. Motiram Nandram, claimed to deduct from their taxable income a sum of Rs. 39,500 as a loss in business. The section of the Act applicable would be Sec. 10 (2) (ix), which allows deduction of "any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains." The circumstances in which the assessees had made the original deposit of Rs. 50,000 with the White Kerosene and Mineral Oil Company of

Bombay in order to secure an organizing agency from them as embodied in agreement (Appendix A) dated 17-12-30 have been set forth in both the opinions and I need not repeat them. SUBHEDAR, A.J.C., holds that—

“The assessees *being money-lenders by profession*, the deposit of Rs. 50,000 on the above terms must therefore be understood to have been made by them in the course of their money-lending business out of their floating or circulating capital (stock-in-trade) and not by way of investment of fixed capital”.

He therefore holds that the loss is a trading loss, which they are entitled to deduct.

2. On the other hand POLLOCK, A.J.C., agrees with the income tax authorities that :

“the deposit was money invested in acquiring a new business and that it was not a loan made in the course of the assessees’ money-lending business, nor money laid out in the ordinary course of an existing business. It was an expenditure in the nature of capital”.

3. The question is no doubt not free from difficulty, as no clear-cut definition of the phrases ‘circulating capital’ and ‘fixed capital’ can be given, and whether any particular expenditure was in the nature of capital must depend on the particular circumstances of each case. The citation of other cases, therefore is useful only by the way of analogy. It would also seem that the transaction entered into between the assessee and the oil Company was one of dual nature. From one point of view it was a loan or deposit of Rs. 50,000 on which interest at 7 per cent. per annum was received; from the other point of view it was the consideration paid for securing this organising agency.

4. There are, however, certain considerations which would in my view make it inaccurate to describe this venture as a new business. The sum of Rs. 50,000 is, according to paragraph 4 of the agreement (Appendix A), put at the disposal of the Company for the purpose of the Company’s business. Paragraph 13 provides that the Organising Agents are not to effect any sales of the Company’s goods themselves. Their duties were to organise the network of selling agents to be guaranteed by them but appointed by the company. Thus they were not actually carrying on the Company’s business itself. Again the sum deposited is to be repaid out of the deposit made by the Selling Agents. It is clearly not a security deposit which would not be so repayable. It would be

also anomalous to describe it as investment of money in a business because in such a case there would be no agreement for its repayment. The transaction, therefore, seems to partake more of the nature of a loan. No doubt the actual interest attached, 7 per cent. is small, but in practice this is made up by commission. So the result is the same as if the money had been lent out at higher interest. The case cited by POLLOCK, A.J.C., in paragraph 3 of his opinion *Charles Marsden & Sons v. Commissioners of Inland Revenue* (12 Tax Cases 217), seems to me to be distinguishable. There money was advanced in order to secure supplies of wood-pulp. It bore interest and was to be repaid gradually as the supplies were made. This amounted really to a payment of price in advance, and with all due respect I do not see how it was necessary to call that a capital expenditure. The illustration given by SUBHEDAR, A.J.C., of a proprietor borrowing from a money-lender and at the same time appointing him manager of the estate seems to be in point. Learned Counsel for the Commissioner of Income-tax refers me to *Kangra Valley Slate Co. Ltd. v. Commissioner of Income Tax, Punjab and N. W. F. Provinces* reported at page 375 of the Reports of Income Tax Cases, Vol. 7. The expenditure there was incurred in defending the Company's rights as lessees in a suit brought against the Company for possession of certain lands with quarrying rights. It was held that this was capital expenditure incurred to retain a capital asset. These facts are also distinguishable, but LORD DUNEDIN's criterion quoted at the end of the case is of general application. He said :

"I think it is not a bad criterion of what is capital expenditure as against what is income expenditure, to say that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year".

In the present case the money was not going to be spent once and for all, but to be returned with interest. That case, therefore, really favours the assessee. On the whole I prefer the view taken by SUBHEDAR, A.J.C., and think that the transaction should be looked upon as a variation of extension of the assessee's money-lending business and that the consequent loss should be deducted from his assessable income.

5. The question referred is therefore answered by me in the negative.

The case was then heard by DIGBY and POLLOCK, JJ., and they delivered the following order on the 1st September 1937.

"In accordance with the opinion of MR. JUSTICE GRUBER the question referred to us must be answered in the negative. We hold that the item of Rs. 39,500 has to be taken as a trading loss and not a loss of capital. The reference is thus decided in favour of the assessee and he will be allowed Rs. 150 as costs in this Court."

Question answered in the negative.

[IN THE BOMBAY HIGH COURT].

COMMISSIONER OF INCOME TAX, BOMBAY

v.

JESINGBHAJI UGARCHAND.

SIR JOHN BEAUMONT, C. J., and BLACKWELL, J.

September 27, 1937.

HINDU UNDIVIDED FAMILY—SEPARATION OF MEMBERS AND CONVERSION INTO FIRM—APPLICATION FOR REGISTRATION OF FIRM AND ASSESSMENT OF FIRM AS SUCCESSOR—MAINTAINABILITY—PROPER MODE OF ASSESSMENT—DUTY OF INCOME-TAX OFFICERS—INDIAN INCOME-TAX ACT (XI of 1922), Secs. 25-A and 26 (2).

Where it is found, and an order is recorded under Sec. 25-A (1) of the Indian Income-tax Act, that a Hindu undivided family, hitherto assessed as undivided, has separated and the joint family property has been partitioned among the various members in definite portions, it is not incumbent on the Income-tax Officer to entertain an application made under Sec. 26-A to register a firm said to consist of all the members of the family so separated and to make an assessment on the firm under the provisions of Sec. 26 (2) even if he is satisfied as to the existence of the firm; on the other hand, it is incumbent on him to make an assessment of the total income received by the joint family as such and hold each member liable for his proportionate share of the tax so assessed under the provisions of Sec. 25-A (2) of the Act.

THONTU CHINNA PULLAYYA AND OTHERS v. COMMISSIONER OF INCOME-TAX, MADRAS [1936] (1937 I.T.R. 132; 9 I.T.O. 377) followed.

Case stated by the Commissioner of Income-tax, Bombay, under Section 66 (2) of the Indian Income-tax Act (XI of 1922) [Civil Reference No. 7 of 1937],

In the matter of the Income-tax and Super-tax assessment of Messrs. Jesingbhai Ugarchand a Hindu Undivided Family of Ahmedabad, for the year 1935-36.

STATEMENT OF CASE.

“Under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as “the Act”), and at the instance of Messrs. Jesingbhai Ugarchand of Ahmedabad (hereinafter referred to as “the assessee”), I have the honour to refer to your Lordships for favour of decision, the question of law set out in paragraph 5 below arising out of the order passed by the Assistant Commissioner of Income-tax, Northern Division, under Sec. 31 of the Act in the matter of the income-tax and super-tax assessments of the assessee for the financial year 1935-36 ended on 31st December 1936.

2. **Facts of the case.**—The Hindu undivided family of Messrs. Jesingbhai Ugarchand consisted of himself and his seven sons. The sources of income of the family were business in cloth, brokerage, property, dividends etc. Up to and including the financial year 1934-35, the assessee was assessed as Hindu undivided family on the sources of income mentioned above. In the course of the assessment proceedings for the financial year 1935-36, however, the assessee claimed that the family hitherto assessed as undivided had separated, that the joint property was partitioned amongst the members within the meaning of Sec. 29-A of the Act and that the business had been taken over by a firm consisting of himself and his sons, one of whom Sarabhai was a minor. In support of this claim, a copy of a partition deed in Gujarati executed on 1st October 1935 was produced. A translation of the said copy is hereto annexed and marked Exhibit A. An application for registration of the firm under Sec. 26-A was also filed accompanied by a deed of partnership in Gujarati dated the 9th November 1935 and it was urged that so far as the business income was concerned, the provisions of Sec. 26 (2) of the Act applied and that the assessment should be made thereunder on the said firm as the person succeeding to the said business. A copy of the application and a translation into English of the partnership deed produced are hereto annexed and collectively marked Exhibit B. The Income-tax Officer thereafter held an enquiry into the fact of the alleged partition after serving notices upon the members of the family and came to the conclusion that as the separation had taken place at the end of Samvat 1991 (the accounting year for the assessment in

question being Samvat 1990) it was premature to arrive at any finding under Sec. 25-A. The claim under Sec. 25-A was accordingly rejected by the Income-tax Officer, and the assessee was assessed to income-tax and super-tax on an income of Rs. 75,492. The Income-tax Officer further held that Sec. 26 (2) did not apply. A copy of the assessment order dated 15th February 1936 is hereto annexed and marked Exhibit C.

3. Against the above orders of the Income-tax Officer, the assessee preferred three separate appeals to the Assistant Commissioner of Income-tax, Northern Division, Ahmedabad, with one of which this reference is not concerned. The other two referred to the Income-tax Officer's refusal (a) to record an order under Sec. 25-A and (b) to grant registration of the firm under Sec. 26-A of the Act. The Assistant Commissioner heard the appeals under Sec. 31 of the Act and confirmed the action of the Income-tax Officer by his appellate orders dated 18th April 1936, holding that as no partition had in fact been effected, the question of the application of Sec. 26 (2) to the case did not arise for consideration, partition being a condition precedent to the conversion of a Hindu undivided family to a partnership firm. A copy of the appellate order is hereto annexed and marked Ex. D.

4. Being dissatisfied with the orders of the Assistant Commissioner, the assessee applied to the Commissioner of Income-tax requesting him to either revise under Sec. 33 of the Act, the Assistant Commissioner's decision or refer the case under Sec. 66 (2) of the Act to this Honourable Court. A copy of the petition put in under the latter section dated 27th May 1936 is annexed hereto and marked Exhibit. E. After considering all the facts of the case, the Commissioner held that the family had separated and that the joint family property had been partitioned as required by Sec. 25-A of the Act. Consequently, the Income-tax Officer was directed to pass an order under Sec. 25-A recording that the undivided Hindu family was separated and that a partition in definite portions had taken place among its members. In regard, however, to the claim that Sec. 26 (2) should be applied and not Sec. 25-A (2), the Commissioner held as the members of the family had all continued the business after partition, Sec. 25-A (2) would operate for the assessment year 1935-36 to the exclusion of Sec. 26 (2) and that any application made for registration would have to be considered in connection with the assessment for the following year, *vis.*, 1936-37. A copy of the order passed under Sec. 33 by the Commissioner dated 15th July 1936 is hereto annexed and marked Exhibit F. In

view of the aforesaid findings and order of the Commissioner, the assessee was requested to state whether he desired to have the case referred to the High Court in the matter of the claim that Sec. 26 (2) of the Act should be applied and not Sec. 25-A (2) and ultimately after certain further correspondence the assessee replied through their accountants Messrs. Nagindas and Maneklal by their letter dated 19th September 1935, requesting that the case should be referred to the High Court. With this letter they sent a copy of a letter from Messrs. Payne and Company dated the 7th September 1936 wherein it was submitted that the following was the proper question to be referred to the Court :—

“Whether in view of the finding and order of the Commissioner dated 15th July 1936, assessment ought not to have been levied for 1935-36 on the footing of the partition and separation and change of status and partnership which were in operation on the date of assessment, namely, 15th February 1936.”

A copy of the correspondence above referred to is hereto annexed and marked collectively as Ex. G. I accordingly submit the case to your Lordships for favour of decision.

5. Question of law for the decision of the Honourable Court.—

The question of law above suggested does not appear to me to be appropriate and I submit that the following question covers the point in dispute and it is accordingly submitted for decision :

“Whether in a case where it is found as a fact, and an order is recorded under Sec. 25-A (1) of the Indian Income-tax Act, that a Hindu family, hitherto assessed as undivided, has separated and the joint family property has been partitioned among the various members in definite portions, it is incumbent on the Income-tax Officer to entertain an application made under Sec. 26-A to register a firm said to consist of all the members of the family so separated, and if satisfied as to the existence of such a firm, to make the assessment thereon under the provisions of Sec. 26 (2) or whether it is incumbent on him to make an assessment of the total income received by the joint family as such and hold each member liable for his proportionate share of the tax so assessed under the provisions of Sec. 25-A (2) ”.

6. Opinion of the Commissioner.—As Sec. 66 (2) of the Act requires me to give my opinion while forwarding this reference, I beg to state that in my respectful opinion Sec. 25-A (2) of the Act applies and not Sec. 26 (2) on which the assessee relies. The former section was introduced by the Income Tax Amendment Act III of 1928, and the reason for its enactment was to provide

especially for cases in which the members of an assessee assessed in the past as an undivided Hindu family have been proved to have separated and there is a partition of the joint family property. Sub-sec. (1) of Sec. 25-A provides first of all for an enquiry by the Income-tax Officer when such a partition is alleged. He is to hold the enquiry into the fact of partition after serving notices upon all the members of the family and if satisfied, he is to record an order stating that the joint family property has been duly partitioned amongst its members. Sub sec. (2) then lays down that when such an order has been recorded, the Income-tax Officer must levy an assessment in the manner laid down therein. This sub-sec. (2) is imperative and leaves no option whatever to the Income-tax Officer to levy an assessment in some other manner. Not only was the Income-tax Officer thus bound to apply Sec. 25-A (2) but, as in this case the very same persons who were doing the business continued to do it after separation, it can hardly be said that another person had succeeded to the business within the meaning of Sec. 26 (2) of the Act. There would have been a succession by another person within the meaning of the aforesaid Sec. 26 (2) had *all* the members of the family not entered into a new partnership or if all the members had continued the whole family business, but with some outsider as an additional member in the partnership. Even if it be held that the joint family had been succeeded in its business by a firm, in accordance with the legal maxim that "*generalia specialibus non derogant*", Sec. 25-A (2) would apply and not Sec. 26 (2) as the latter is a general section providing for all cases of succession where a business, profession or vocation is concerned.

7. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act".

The Advocate-General with the Government Solicitor for the Commissioner.

M. C. Setalvad with Payne and Co., for the Assessees.

JUDGMENT.

BEAUMONT, O. J.—This is a reference by the Income-tax Commissioner arising in these circumstances. The Assessees were a Hindu undivided family consisting of a father and seven sons, and on the finding of the Commissioner they separated during the year of assessment. Shortly after the separation of the family, the father and his seven sons, that is to say, exactly, the same persons as constituted the joint family, formed themselves into a firm, and

asked the Income-tax Officer to register it. The question which the Commissioner of Income-tax propounds is :

“ Whether in a case where it is found as a fact and an order is recorded under Sec. 25-A (1) of the Indian Income Tax Act, that a Hindu family hitherto assessed as undivided, has separated and the joint family property has been partitioned among the various members in definite portions, it is incumbent on the Income-tax Officer to entertain an application made under Sec. 26-A to register a firm said to consist of all the members of the family so separated, and if satisfied as to the existence of such a firm, to make the assessment thereon under the provisions of Sec. 26 (2) or whether it is incumbent on him to make an assessment of the total income received by the joint family as such and hold each member liable for his proportionate share of the tax assessed under the provisions of Sec. 25-A (2) ”.

In substance what it really comes to is that if the members of the separated joint family are assessed under Sec. 25-A (2) they have to pay the whole tax which would have been assessed on the joint family in the proportions in which they are interested in the joint family property, and they cannot claim any deduction in respect of the lower rate of tax to which they might as individuals have been entitled, as they can in the case of a registered firm under Sec. 48 (2) of the Income-tax Act. Now this case is absolutely on all fours with a case which came before a Full Bench of the Madras High Court, *Chinna Pullayya and Others v. The Commissioner of Income Tax, Madras*, and the Court there held that as the firm consisted of exactly the same individuals as the previous joint Hindu family, there had been no succession within the meaning of Sec. 26 (2), and that the assessment must be made under Sec. 25-A (2). It is clearly not desirable that conflicting decisions under the Act which applies to the whole of British India should be given by different High Courts on exactly similar facts, and we propose, therefore, to follow the Madras case without expressing any opinion of our own. The second part of the question, therefore, will be answered in the affirmative, and the first part in the negative. Assesseees to pay the costs of the Commissioner on the Original Side scale to be taxed by the Taxing Master, less the deposit of Rs. 100.

BLACKWELL, J.—I agree.

Reference answered accordingly.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME TAX, BOMBAY

v.

AHMEDABAD ADVANCE MILLS, LTD.

SIR J. W. F. BEAUMONT, C. J., and BLACKWELL, J.

September 27, 1937.

FOREIGN INCOME—INCOME INVESTED IN PURCHASE OF GOODS—GOODS BROUGHT TO BRITISH INDIA—INCOME WHETHER ASSESSABLE—CONSTRUCTIVE RECEIPT—CONVERSION OF INCOME INTO CAPITAL—INDIAN INCOME-TAX ACT (XI of 1922), Sec. 4 (2).

In order to attract income tax in India under Sec. 4 (2) of the Indian Income-tax Act what is brought to India must be income, profits or gains, and if the assessee converts income received abroad into capital, and then brings that capital to India he is not bringing into India income, profits or gains. Whether the foreign income has in fact been capitalised or not must be a question of fact in each case. But, if the court comes to the conclusion that in fact what is brought to this country is a capital asset the fact that that capital asset was acquired out of income in a foreign country, is irrelevant.

The assessee, a company registered in India, received in England interest on sterling securities to the extent of Rs. 18,333. They invested that income in the purchase of certain mill stores and machinery in England and brought the articles purchased to British India in the assessment year 1936-37. They were assessed to income tax in British India in respect of this amount on the ground that the income in question was brought to British India within the meaning of Sec. 4 (2) of the Indian Income-tax Act when the goods purchased were received in British India. On reference by the Commissioner of Income-tax :

Held, that the income received by the assessee in England was capitalised by the purchase of stores and machinery, it was not received in or brought into India within the meaning of Sec. 4 (2) and the assessee was not accordingly liable to pay income-tax on this amount.

GRESHAM LIFE ASSURANCE SOCIETY v. BISHOP [1901] (1902 A.C. 287 ; 4 Tax Cas. 464 ; 1901, 1 K.B. 153 ; 70 L.J.K.B. 298 ; 88 L.T. 654).

Case stated by the Commissioner of Income-tax, Bombay under Sec. 66 (2) of the Indian Income-tax Act, 1922, in the

matter of the Income-tax and Super-tax assessments of the Ahmedabad Advance Mills Ltd., of Bombay, for the year 1936-37, (Civil Reference No. 9 of 1937).

STATEMENT OF CASE.

"MY LORDS, under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as the "Act") and at the instance of the Ahmedabad Advance Mills Ltd., (hereinafter referred to as the "Company"), I have the honour to refer for your Lordships' decision, the question of law set out in paragraph 5 below, which has arisen out of the income-tax and super-tax assessments of the Company for the financial year 1936-37, ended on 31st March 1937.

2. **Facts of the Case.**—The assessee Company is a Company registered in British India and for the current financial year 1936-37 has been assessed by the Income-tax Officer, Companies Circle, Bombay, to income-tax at Rs. 6,457-11-0 and super-tax at Rs. 4,833 on a total income of Rs. 1,21,380. A copy of the Assessment Order, dated 25th July 1936, is annexed hereto and marked Exhibit A.

3. Against the above decision, the Company appealed to the Assistant Commissioner of Income-tax, B Division, Bombay, by its petition, dated 31st August 1936, objecting *inter alia* to the inclusion in the income assessed of a sum of Rs. 18,333 on account of interest on $5\frac{1}{2}$ per cent. 1936-38 Sterling Bonds of the Government of India, on the ground that the said interest was payable in England, was received in England and actually expended there and never brought into British India. A copy of the said petition together with a copy of the forwarding letter sent therewith is annexed hereto and marged Exhibit B. The Income-tax Officer was of opinion that the amount in dispute was constructively brought into British India within the meaning of Sec. 4 (2) of the Act on the ground that though the Company did not bring it in cash, it was utilised in purchasing certain goods in England which were brought to Bombay on purchase. He relied on the decision of the Madras High Court in the case of *L.C.T.S.P. Subramanyam Chettiar* (IX I.T.C. 47). On hearing the appeal the Assistant Commissioner upheld the view of the Income-tax Officer. A copy of his appellate order is annexed hereto and marked Exhibit C.

4. Against the Assistant Commissioner's order the Company petitioned to me to revise under Sec. 33 of the Act the order passed by the Assistant Commissioner and exclude the said item

from the income liable or refer the case under Sec. 66 (2) of the Act to this Honourable Court. A copy of the company's petition, dated 5th January 1937, is hereto annexed and marked Exhibit D. It referred to one other item too but as I have given relief in respect thereto, nothing remains to be done. As regards the item of Rs. 18,333, however, I am unable to grant any relief and am therefore submitting this Statement of the Case.

5. *Question for the Decision of the Honourable Court*:—I submit the following question for favour of decision:—

“Whether in the circumstances of the case, the Income-tax Officer has rightly included in the income liable to tax, the amount of Rs. 18,333 on account of interest on sterling securities on the ground that though the said income accrued or arose in England, it was received in or brought into British India within the meaning of Sec. 4 (2).”

Opinion of the Commissioner:—As Sec. 66 (2) of the Act requires me to give my opinion while submitting this reference I beg to say that the simple facts of the case are that the Company received the above amount of interest in London and with it purchased certain mill stores and machinery required for its business here and brought them into British India. The relevant section of the Act is Sec. 4 (2) which lays down that “Income, profits or gains accruing or arising without British India to persons resident in British India, shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India.....” Now, there are various methods of bringing into British India what one receives outside it. The Company received in England the said interest in sterling not in rupees. It could have brought the pounds, shillings and pence it actually received or it could have converted the amount into rupees and brought them here or it could have got a draft or a cheque from a Bank in England with a Branch in Bombay for the said amount, either in sterling or in rupees or it could have converted it into something else and brought that into British India. Surely, the above provision in the Act does not mean that the company could be said to have brought the income into British India only if it had brought here the very pounds, shillings and pence it actually got in London by way of interest on the sterling loans. In the first place, the section does not say any such thing and secondly, its enactment would be useless were such a construction put upon it as income would be received outside British India not in rupees but in some foreign currency almost invariably and any one who converted that into

rupees before bringing it here would pay no tax. One may bring pounds, shilling and pence, or convert them into dollars or rupees or gold or silver or any other material before bringing here the amount earned abroad but all that would amount to bringing the income here. Again the section does not say that the income should have been brought here in cash before it could be taxed and I do not think there can be any doubt in this case, that the income was brought into British India within the meaning of this section as soon as the goods purchased were brought here. Even when the foreign income was not brought into British India at all but was utilised in paying off an Indian debt, it has been held that the income could be said to have been received constructively in British India (*vide* the case of *L.C.T.S.P. Subramanyam Chettiar v. Commissioner of Income Tax, Madras*, 9 I.T.C. 47). Hence I submit the answer to the question should be in the affirmative.

7. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act."

The *Advocate-General* with the *Government Solicitor* for the Commissioner.

Sir Jamshed B. Kanga and *F.J. Coltman* with *Ardeshir, Hormusji Dinshaw & Co.*, for the Assesseees.

JUDGMENT.

BEAUMONT, C.J.—This is a reference by the Income tax Commissioner under Sec. 66 (2) of the Act raising a short point. The assesseees are a limited company, and in the year of assessment they had certain income amounting to Rs. 18,000 odd, which they received in London. They invested that income, or at any rate the bulk of it, in the purchase of stores and machinery in England, which they had shipped to Bombay, and the question is whether they are liable to pay income-tax on so much of the stores and machinery as represent income received by them in London; in other words, whether the income received by them in London has been constructively brought into British India. The question turns on the construction of Sec. 4 (2) of the Indian Income-tax Act. That sub-section provides: "Income, profits or gains accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be income, profits or gains of the year in which they are so received or brought, notwithstanding the fact that they did not so accrue or arise in that year." The sole question is whether stores or machinery can be regarded as income. There is, in my opinion, no doubt

that income received in a foreign country may be brought into India in some form other than that in which it is actually received. Foreign income may be received in sterling or francs or dollars, and may be brought into British India in the form of rupees, or income received abroad may be remitted to India by means of a banker's draft. To use LORD BRAMPTON's phrase in the Gresham Case [*Gresham Life Assurance Society Ltd v. Bishop*, (1902 Appeal Cases 287)] the income may be received "in specie or in any form known to the commercial world for the transmission of money from one country to another". But it seems to me that in order to attract income-tax in India what is brought into this country must be income, profits or gains, and if the assessee has converted income received abroad into capital, and then brings that capital to India, he is not bringing into India income, profits or gains. Whether the foreign income has in fact been capitalised or not must be a question of fact in each case. In the present case there is, in my opinion, no doubt that the income was capitalised by the purchase of machinery and stores. It is not suggested that the machinery or stores were brought into this country for the purpose of being sold and the proceeds applied as income. One can easily imagine a case which an assessee in this country, desirous of bringing into this country foreign income for use as income in India, might convert the foreign income into some form of capital by purchase of bonds or otherwise, bring the bonds to this country and then sell them and apply the proceeds as income. In such a case I apprehend the Court would probably hold that what had been brought into this country was in fact income and not capital. But, if the Court comes to the conclusion that in fact what is brought into this country is a capital asset, the fact that that capital asset was acquired out of income in a foreign country is, in my view, irrelevant. The actual question raised by the Commissioner of Income-tax is, "Whether in the circumstances of the case, the Income-tax Officer has rightly included in the income liable to tax, the amount of Rs. 18,338 on account of interest on sterling securities on the ground that though the said income accrued or arose in England, it was received in or brought into British India within the meaning of Sec. 4 (2)?" In my opinion we should answer the question in the negative. The Commissioner to pay the Assessee's costs on the Original Side scale to be taxed by the Taxing Master.

BLACKWELL, J.—I agree and have nothing to add.

Reference answered accordingly.

[IN THE PRIVY COUNCIL].

COMMISSIONER OF INCOME TAX, BOMBAY

v.

SARANGPUR COTTON MANUFACTURING CO. LTD.

LORD THANKERTON, LORD WRIGHT and SIR GEORGE RANKIN.

November 5, 1937.

ACCOUNTING—ASSESSEE EMPLOYING REGULAR METHOD—DUTY OF INCOME TAX OFFICER TO CONSIDER WHETHER INCOME CAN BE PROPERLY DEDUCED THEREFROM—SYSTEMATIC UNDERVALUATION OF STOCK FOR 'SECRET RESERVE'—ASSESSEE'S RIGHT TO SHOW THAT REAL INCOME IS LESS THAN PROFIT SHOWN IN BALANCE-SHEET—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 13.

The view that an Income Tax Officer is prima facie entitled to accept the profits shown by the assessee's accounts where there is a method of accounting regularly employed by the assessee, is not a correct view. It is the duty of the Income Tax Officer where there is such a method of accounting, to consider whether the income, profits and gains can be properly deduced therefrom, and to proceed according to his judgment on the question.

Sec. 13 of the Indian Income Tax Act relates to a method of accounting regularly employed by the assessee for his own purposes and does not relate to a method of making up the statutory return for assessment to income-tax. Further, the section clearly makes such a method of accounting a compulsory basis of computation, unless, in the opinion of the Income Tax Officer, the income, profits and gains cannot properly be deduced therefrom. It may well be that though the profits brought out in the accounts is not the true figure for income-tax purposes, the true figure can be accurately deduced therefrom and the judgment of the Income tax Officer under the proviso to that section must be properly exercised in such cases. It is misleading to describe this duty as a discretionary power.

The assessees employed a regular method of accounting but had also for some years past adopted regularly a method of valuation of stock by taking some price under both cost and market price with the object of creating a 'secret' reserve, which involved the retention of profits so as not to be included in the profits shown to the shareholders. For the account year 1930 the assessees submitted their profit and loss account showing a profit of Rs. 2,64,086 and a return of the total income of the company showing an income of Rs. 1,99,086 which was arrived at by taking into account the result of

undervaluation of stock which the company had adopted in the previous years. The Income-tax Officer, without considering whether the true income could be arrived at from the method of accounting employed by the assessee, held that the assessee was bound by the profit shown in the balance sheet : Held, that the Income tax Officer was not entitled to take the profit shown in the balance sheet as the real income of the assessee but was bound to consider whether the true income could be deduced from the account of the assessee and to proceed according to his judgment on this question.

Appeal from a judgment of the Bombay High Court dated March 28, 1935, in the matter of the assessment of the Sarangpur Cotton Manufacturing Co. Ltd., for the year of account ending on December 31, 1930.

J. M. Tucker, K. C., and Hubert Hull, for the Appellant.

R. P. Hills, for the Respondent.

JUDGMENT.

LORD THANKERTON.—This is an appeal from a Judgment of the High Court of Judicature at Bombay, dated March 28, 1935, upon a question of law referred to the High Court by the present appellant under Sec. 66 of the Indian Income-tax Act, 1922.

The question arises out of the assessment of the respondents to income tax for the financial year ending March 31, 1932, and concerns the computation of the profits or gains of their business for the year of account ending on December 31, 1930, under Sec. 10 of the Act.

The respondents are a limited liability company doing business at Ahmedabad as manufacturers of cloth and yarn. For the purpose of their assessment for the year ending March 31, 1932, they made a return under Sec. 22 (1) of the Act on July 18, 1931, to the Income-tax Officer which consisted of (a) a copy of the audited balance sheet and profit and loss account of the Company for the accounting year ending on December 31, 1930, which showed the profit for the year as Rs. 2,64,086, (b) a return of the total income of the Company for assessment, which included the income, profits and gains as per profit and loss account for the accounting year as Rs. 1,89,086 and (c) a covering letter which explained the adjustment of the figure in the profit and loss account so as to arrive at the figure of income in the return, and which was in the following terms :—

“ We herewith beg to enclose the Income-tax Form No. 4449 for the year 1931-32 duly filled in showing therein the profits as

per statement shown below, which please receive and pass the receipt for the same.

Rs.	Profit as per Balance sheet for the year ending
2,64,086.	December 31, 1930.
3,48,353.	Add Difference for the undervaluation in Stock
	at the end of 1930 (at market rate).
<hr/> 6,07,439	
3,97,634	Less Difference for the undervaluation in Stock
	at the end of 1929.
2,09,805	
10,719	Less Premium received by sale of Government
	Bond of 1932.
<hr/> 1,89,086	

"The printed copy of the Balance sheet for the year 1930 is enclosed herewith which please note".

On receipt of the above return the Income-tax Officer issued a notice under Sec. 23 (2) of the Act on the assessees to produce evidence in support thereof, and, in compliance the assessees duly produced their closed accounts for the accounting year. The assessees contended before the Income-tax Officer,

(1) that the undervaluation of the closing stock of the assessee company for the year 1929 disallowed by Rs. 3,97,634 in the assessment year 1930-31 should be allowed as an addition in the opening stock of the current 1930, and that the undervaluation of the closing stock of the Company by Rs. 3,59,966, should also be added in the closing stock of the Company in the current assessment:

(2) that the method of adopting the undervaluation of the opening as well as closing stocks was adopted by this office in previous assessment and that it should not be departed from in the current year's assessment:

(3) that the ruling in the case of *Commissioner of Income-tax, Bombay v. Ahmedabad New Cotton Mills Co. Ltd.* (57 I.A. 121) is also in consonance with the method adopted by this office in considering the undervaluations of both the opening and closing stocks in computing the income of the Company for income-tax purposes.

In his assessment order of February 26, 1932, the Income-tax Officer states :—

"As regards above contentions, according to the Privy Council's decision in *Commissioner of Income-tax, Bombay v. Ahmedabad New Cotton Mills Co. Ltd.*, I understand that if the under-

valuation of the closing stock of any assessee is considered in the assessment in any year, the undervaluation of the opening stock should also be considered in his assessment of that year: but if the undervaluation of the closing stock is not considered in the assessment the undervaluation of the opening stock should also be left out of the same assessment. I accordingly set aside the question of the undervaluations of the opening as well as the closing stocks of the assessee Company in the current year's assessment and accept the profit of Rs. 2,64,086 shown in the statement of the profit and loss account of the Company. Under the circumstances, the claim of the assessee Company for Rs. 37,668 as a deduction from the current year's assessment is rejected".

On an appeal by the assessees, the Assistant Commissioner of Income-tax confirmed the assessment by his order dated November 22, 1932. The assessees then applied to the present appellant to review the above orders under Sec. 33 of the Act, or alternatively, to make a reference of questions of law to the High Court under Sec. 66 (2) of the Act. The appellant declined to review the orders, and, on the ground that no legal point was involved he also declined to make reference. Thereafter the High Court, on an application by the assessee under Sec. 66 (3) of the Act, required the appellant to make a reference and he made the present reference with the question of law as formulated by the High Court, *viz.*

"Whether in view of the provisions of Sec. 13 of the Income-tax Act or otherwise the Income-tax Officer was right in computing for the purpose of Sec. 10 of the Act income, profits and gains in accordance with the method of accounting regularly employed by the assessee whether or not that method in fact shows the true income, profits and gains".

The appellant suggested the substitution of another question, but his suggestion was not adopted by the High Court. The Court, however without referring the case back amended the question referred as follows:—

"Whether in the circumstances of the case the Income-tax Officer was entitled to compute the income, profits and gains of the assessees upon the basis of the printed copy of the profit and loss account sent with the letter of the assessees of July 18, 1931, without regard to any undervaluation of the stock which may have been or may be proved to have been made". "

By their order dated March 28, 1935, the High Court amended the question accordingly and answered the amended question in the negative. Their opinion was that the covering letter of

July 18, 1931, formed part of the method of accounting employed by the assessee within the meaning of Sec. 13 of the Act and that the Income-tax Officer was not entitled to split up the method of accounting and to regard the profit and loss account apart from the covering letter; that the Income-tax Officer had only accepted a portion of the method, without taking the method as a whole, which he was not entitled to do. They therefore held that the matter was still at large for the proper decision of the Income-tax Officer.

Their Lordships find themselves unable to agree with the view of the High Court as to the meaning of Sec. 13 of the Act, which provides as follows :

"13. Income, profits and gains shall be computed for the purposes of Secs. 10, 11 and 12 in accordance with the method of accounting regularly employed by the assessee."

"Provided that, if no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine".

Their Lordships are clearly of opinion that the section relates to a method of accounting regularly employed by the assessee for his own purposes—in this case for the purposes of the Company's business—and does not relate to a method of making up the statutory return for assessment to income-tax. Secondly, the section clearly makes such a method of accounting a compulsory basis of computation unless in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom. It may well be that, though the profit brought out in the accounts is not the true figure for income-tax purposes the true figure can be accurately deduced therefrom. The simplest case would be where it appears on the face of the accounts that a stated deduction has been made for the purpose of a reserve. But there may well be more complicated cases in which nevertheless, it is possible to deduce the true profit from the accounts, and the judgment of the Income-tax Officer under the proviso must be properly exercised. It is misleading to describe the duty of the Income-tax Officer as a discretionary power.

Despite some statements in the reference which will be referred to later, their Lordships agree with the High Court that the facts stated make clear that here the Income-tax Officer has

never exercised his judgment under the proviso, and their Lordships are further of opinion that, if he had so exercised his judgment, the Income-tax Officer would not reasonably have come to any other opinion than that the profit shown in the profit and loss account could not be the true figure for Income-tax purposes.

It is necessary now to consider some of the statements to be found in the reference, in addition to the passage already cited from the assessment order of the Income-tax Officer. In the order of the Assistant Commissioner on the appeal the following passages occur :—

“It is only for the past five years that the opening and closing stocks have been revalued because they were found to be grossly undervalued, but the Income-tax Officer now finding that the stocks (opening and closing) are being systematically and regularly valued at lower rate, he has deemed it fit to accept the profits as shown by accounts, as according to him the accounts do show real profits. Under Sec. 13 of the Act ‘income, profits and gains shall be computed for the purposes of Secs. 10 (business), 11 and 12, in accordance with the method of accounting regularly employed by the assessee’. In this case the method of accounting has been found to be regularly and properly employed, hence the Income tax Officer was *prima facie* entitled to accept the profits shown by the accounts.....At any rate, the Privy Council decision nowhere forbids the Income tax Officer to accept the profits shown by the accounts in future ; as a matter of fact, the decision relates to one year only, and if the Income-tax Officer has now accepted the accounts, I think he was quite within his powers to do so, for the discretion vests in him and it is absolute.

“Perhaps I should also remark here that the Income-tax Officer has not in this case put any fictitious values of stocks of goods of his own nor has he thus taken any fictitious profits. As a matter of fact, the Company admits that they do not keep proper cost accounts and that the cost price worked out for revaluation of stocks is also approximate. Thus the revalued stocks also do not show real profits. What strikes me rather strange is that while the duly audited and certified balance sheet and profit and loss account according to the accounts of the Company is presented to the shareholders as representing the true state of affairs and real profits of the Company, the Company say to the Income-tax Department that the profits shown by them in their accounts and certified and duly audited balance sheet and profit and loss account is unreal ”.

Two important findings of fact are made in the letter of reference, *viz.*, (1) the assessees have been found to have been regularly adopting all along the method of accounting which they followed for the year 1930 and (2) the method of valuation of stocks by taking some price under both cost and market price adopted for the year 1930 has been regularly employed by them for years past.

This makes clear that the method of accounting regularly employed by the respondents comes within the meaning of Sec. 13 and it, therefore, became the duty of the Income tax Officer to consider whether, in his judgment, the income, profits and gains for the purpose of Sec. 10 could be properly deduced from the accounts. In their Lordships opinion, it is abundantly clear that he never applied his mind to this question, but held himself entitled to hold the respondents to the figures of profit brought out in these accounts. The Assistant Commissioner took the same view, although he recognised that these figures did not show real profits. The views expressed by these two officers make it impossible to accept three statements by the appellant in the letter of reference *viz.*, (a) in para 4: "After examination of the accounts, the Income tax Officer being satisfied that the accounts showed the true income, profits or gains, accepted them"; (b) in para 5: "The Income-tax Officer however accepted, as correct the profit of Rs. 2,64,086 as shown in the assessee's profit and loss account and considered that there was no need to revalue the stocks; and (c) in para 8: "The Income tax Officer's finding was that the true income, profits and gains of the assessee could be properly deduced for the calendar year 1930 from the above method of accounts regularly employed by the assesseees".

These statements are quite inconsistent with the statements already referred to, and further, the facts would seem to show that the Income tax Officer could not reasonably have come to the conclusion that the profit shown in the profit and loss account was the true profit for income tax purposes. It is found that the undervaluation in the 1930 accounts is of the same nature and on the same basis as that in previous accounts, which is referred to by the Assistant Commissioner as gross undervaluation. This is confirmed by the actual figures; taking the undervaluation of the closing stocks in the previous assessments, which, except in the present year, have been taken as the undervaluation of the opening stock in the succeeding assessment, the figures are as follows :—

Year of Assessment.	Year of Account	Under- valuation.
1927-28	1926	3,86,642
1928-29	1927	4,15,208
1929-30	1928	3,15,127
1930-31	1929	3,97,634

The last figure is that claimed by the assessees as the under-valuation of the opening stock in the accounting year of 1930, which is here in question. The Income-tax Officer could not reasonably conclude that the true profits could be properly deduced from a gross undervaluation.

Lastly, if there were any doubt, the appellant himself has put the matter beyond possibility of doubt, by the statement in his order of April 16, 1933, that the object of the undervaluation was the creation of a "secret" reserve, which involves the retention of profits so as not to be included in the profits shown to the shareholders by the profit and loss account and balance sheet, but which constitute part of the taxable profits. This negatives any suggestion that these accounts show the true profit for income-tax purposes.

Their Lordships desire to add that the view of the Assistant Commissioner that the Income-tax Officer is *prima facie* entitled to accept the profits shown by the accounts, where there is a method of accounting regularly employed by the assessee, is not a correct view. It is the duty of the Income-tax Officer, where there is such a method of accounting to consider whether income, profits and gains can properly be deduced therefrom, and to proceed according to his judgment on this question. It is clear that the Income-tax Officer acted on the same view as that expressed by the Assistant Commissioner, and did not perform the duty above stated. The case of *Commissioner of Income-tax, Bombay v. Ahmedabad New Cotton Mills Co. Ltd.*, is of no assistance on the present question.

Their Lordships prefer the original question formulated by the High Court and embodied in the letter of reference, subject to the conclusion of their Lordships that the facts show that the method of accounting regularly employed by the assessees does not show the true income, profits or gains, and the question should therefore, be amended as follows:—

"Whether in view of the provisions of Sec. 13 of the Income tax Act or otherwise, the Income Tax Officer was right in computing for the purpose of Sec. 10 of that Act, the income, profits and gains

in accordance with the method of accounting, regularly employed by the assessee when that method in fact does not show the true income, profits and gains ”.

This question falls to be answered in the negative. It will now be for the Income tax Officer to proceed to the proper discharge of his duty under Sec. 13 in the light of the opinions above expressed, and doubtless, his experience in the preceding years' assessments will assist him in reaching a proper decision.

Their Lordships will therefore, humbly advise His Majesty that the order of the High Court of March 28, 1935, should be varied by substitution of the amended question above set forth, which should be answered in the negative, and that the appeal should be dismissed with costs.

Appeal dismissed.

Solicitor, India Office : for the Appellant.

Barrow Rogers and Nevill : for the Respondent.

[IN THE BOMBAY HIGH COURT].

WESTERN INDIA LIFE INSURANCE CO. LTD., *In re.*

SIR J. W. F. BEAUMONT, C. J., and BLACKWELL, J.

September 24, 1937.

INSURANCE COMPANY—DEPRECIATION OF SECURITIES—RIGHT TO SET ASIDE SUMS TO RESERVE FUND TO MEET DEPRECIATION AND TO TREAT SUCH SUMS AS BUSINESS EXPENDITURE—SUBSEQUENT APPRECIATION OF ASSETS—EFFECT—COMPANY WHETHER BOUND TO BRING BACK SUMS SO RESERVED—INDIAN INCOME TAX RULES, RULES 25, 30.

In respect of the years 1930 and 1931 there was a substantial depreciation in the investments held by the assessee company and the company set aside each year to a special depreciation account a sum considerably less than the actual amount of depreciation. In the year 1932 there was an appreciation which wiped out the loss of the previous two years leaving a small appreciation in the three years: Held, that under Rule 30 of the Income Tax Rules, the company was entitled to treat the sums set apart to the depreciation reserve fund in the years 1930 and 1931, as expenditure incurred

solely for earning the profits without giving credit for the appreciation which occurred in 1932.

Under Rule 30 of the Income Tax Rules, which provides that any amount either written off in the accounts or through the actuarial balance sheet to meet depreciation of securities or other assets, or which is carried to a reserve fund formed for that sole purpose, may be treated as expenditure incurred solely for the purpose of earning profit, the option lies with the assessee and not solely with the income tax department; and, if there has been a writing off or setting aside to a reserve fund in any particular year and this writing off or setting aside is justified by the state of accounts of the company of that year, the assessee is entitled to treat the amount so written off or set aside as business expenditure, notwithstanding the fact that there was an appreciation of the securities in a subsequent year. There is nothing in the Rule to compel an assessee who has exercised his option to bring back any sums which have been properly set aside by him in accordance with the Rule, merely because there was an appreciation in a subsequent year.

Case stated by the Commissioner of Income Tax, Bombay. In the matter of the supplementary Income Tax and Super-tax assessment of the Western India Life Insurance Company Limited of Satara, for the year 1933-34.

STATEMENT OF CASE.

"My LORDS,—Under Sec. 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as "the Act") and at the instance of the Western India Life Insurance Company Limited of Satara (hereinafter referred to as "the assessee"), I have the honour to refer to your Lordships the question of law set out in paragraph 7 below which has arisen out of the supplementary income-tax and super-tax assessments of the assessee for the financial year 1933-34 ended on 31st March 1934.

2. **Facts of the Case :—**The assessee is a Life Assurance Company and for the above year 1933-34, it was originally assessed on an income of Rs. 2,10,829 on 22nd November 1934 based on the annual average of net profit disclosed by the actuarial valuation for the triennium ended on 31st December 1932, in accordance with Rule 25 of the Income-tax Rules and income-tax and surcharge amounting together to Rs. 20,630-9-0 were charged. A copy of the said rule is annexed hereto and marked Exhibit A. It was thereafter found by the Income-tax Officer that a part of the income liable to tax had escaped assessment and the Income-tax Officer

therefore on 15th March 1935, served a notice on the assessee under Sec. 34 of the Act for the purposes of re-assessment. The assessee thereupon put in a fresh return of income for the year in question dated 22nd August 1935. After hearing the representative of the assessee, the Income-tax Officer then determined the total income at Rs. 2,94,400 and levied in respect thereof income-tax amounting to Rs. 36,520 and super-tax and surcharge amounting to Rs. 19,093-12-0, under his assessment order dated 20th January 1936, a copy whereof is annexed hereto and marked Exhibit B.

3. In arriving at the net profit under the actuarial valuation for the above triennium ended on 31st December 1932, sums amounting to Rs. 1,65,087 were deducted on the ground that they had been transferred by the assessee to the Investment Reserve Fund on account of depreciation in the value of securities held and a further sum of Rs. 9,832, being the profit realised on the sale and maturity of certain securities, was also deducted, having been taken to the credit of the same account. The Income-tax Officer found as a fact that though there was depreciation in the value of the Company's investments during the first two years of the triennium, during the third year there was not only no depreciation on the whole but an actual appreciation to the extent of Rs. 3,266 in the value thereof over their cost value. He also found that there was very substantial appreciation to the extent of Rs. 15,45,648 in the years 1933 and 1934. He therefore, not only disallowed the sums aggregating to Rs. 1,74,919 transferred and credited as aforesaid during the period under consideration but took into account the whole balance standing to the credit of the said Investment Reserve Fund at the end of the said triennial period, namely, Rs. 2,59,919 (which included a sum of Rs. 85,000 which had been transferred thereto at the end of the year 1929), and thus increased the profit for the period by the amount of the whole of such balance.

4. Against the said assessment, the assessee appealed to the Assistant Commissioner of Income-tax objecting to the inclusion of the said amount as well as certain other items with which, however, this reference is not concerned. The Assistant Commissioner, on hearing the appeal agreed with the Income-tax Officer in so far as the disallowance of Rs. 1,74,919 was concerned, holding that there had in fact been no depreciation but on the contrary an actual appreciation of the company's investments in the triennial period taken as a whole, and that in the circumstances such items should not be allowed as expenditure, but modified the assessment

order by allowing a deduction of the above mentioned sum of Rs. 85,000 on the ground that it had already been transferred to the Investment Reserve Fund before the beginning of the triennial period in question. A copy of his appellate order dated 31st March 1936, accompanies marked Exhibit C.

5. Under the Income-tax Act, ordinarily no deduction from the total income is allowable on account of any depreciation in the value of securities held by an assessee. Life Assurance Companies are, however, an exception to this general rule. Their assessments are made under Rules framed by the Central Board of Revenue under the authority vested in it under Sec. 59 (2) (a) (ii) of the Act. In addition to Rule 25 referred to above (Exhibit A), Rule 30 is one of the rules thus framed, under which in circumstances sums carried to a reserve fund formed for the purposes of meeting such depreciation may be treated as an item of expenditure and allowed. A copy of the said rule, upon the terms of which the assessee has based the claim for the above deduction, is annexed hereto and marked Exhibit D.

6. As the Assistant Commissioner declined to give any relief, the assessee has applied under Sec. 66 (2) of the Act for a reference to this Hon'ble Court. A copy of the application made is annexed hereto and marked Exhibit E. Accordingly I submit this Statement of Case for favour of your Lordships' decision.

7. **Question of Law for Decision of the Honourable Court:—**I submit the following question for favour of decision by your Lordships :

“The Assistant Commissioner having found as a fact that in the triennium under consideration, there was an appreciation in the value of the securities held by the assessee, was his action correct in refusing to grant any deduction from the income liable to tax on account of the sum of Rs. 1,74,919 claimed by the assessee under Rule 30 of the Income-tax Rules as an item of expenditure on account of the amounts carried to the Investment Reserve Fund meant to provide for depreciation in the value of the said securities? ”

Besides the above question, the assessee has asked me to refer to your Lordships, the question whether the Income-tax Officer had correctly proceeded to levy an assessment under Sec. 34 of the Act. As this question was not raised in appeal before the Assistant Commissioner, I have no authority to refer it to your Lordships, as Sec. 66 (2) of the Act confines me to questions of law arising out of that officer's appellate order only.

8. **Opinion of the Commissioner.**—As the said Sec. 66 (2) requires me to give my opinion while submitting this Statement of the Case, I beg to add respectfully that the answer to the above question should be in the affirmative. A perusal of Rule 30 (Exhibit D) will show that under it, it is not incumbent on an Income-tax Officer to allow amounts carried to an Investment Reserve Fund to provide for depreciation of the value of the securities held. The words used are “any amount either written off in the accounts or through the Actuarial Valuation Balance Sheet to meet depreciation of, or loss on securities or other assets, or which is carried to a reserve fund formed for that sole purpose and not used for any other purpose, may be treated as expenditure incurred solely for the purpose of earning the profits of the business”. The words used are “may be treated as expenditure” and this wording leaves, it is submitted, full discretion to the Income-tax Officer in this matter. The use of the word “may” in this rule may be contrasted with the use of the word “shall” in Rules 25, 26 and 28, and in the latter part of Rule 30 itself. Taking the triennial period under consideration as a whole, there was, as a matter of fact, no depreciation but actually an appreciation and in the circumstances, I cannot say that the discretion vested in the lower officers was not properly exercised.

9. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act”.

JUDGMENT.

BEAUMONT, C. J.—This is a reference made by the Acting Commissioner of Income-tax in which he raises the following question :—

“The Assistant Commissioner having found as a fact that in the triennium under consideration there was an appreciation in the value of the securities held by the assessee, was his action correct in refusing to grant any deduction from the income liable to tax on account of the sum of Rs. 1,74,919 claimed by the assessee under Rule 30 of the Income-tax Rules as an item of expenditure on account of amounts carried to the Investment Reserve Fund meant to provide for depreciation in the value of the said securities?”

The assessee is a company carrying on life insurance business. The year of assessment is the year 1933-34. Under Rule 25 of the Indian Income-tax Rules framed under Sec. 59 (2) (a) (ii) it is provided ;

"In the case of Life Assurance Companies incorporated in British India whose profits are periodically ascertained by actuarial valuation, the income, profits and gains of the Life Assurance Business shall be the average annual net profits disclosed by the last preceding valuation" with certain statutory additions which may have to be made thereto. Now, in the three years covered by the valuation in the case of the assessee company, which were the years 1930, 1931 and 1932, there was a substantial depreciation in the investments held by the company for the year 1930, and the company set aside to a special depreciation account a sum considerably less than the actual amount of depreciation. In 1931 there was a further and heavier depreciation, and the Directors again set aside to the depreciation reserve fund a further sum, again considerably less than the amount of the depreciation in that year. In the third year there was an appreciation, and the Assistant Commissioner of Income-tax has found as a fact that the loss of the two years was wiped out, and in the three years there was a small appreciation. The question is how on those facts Rule 30 has to be applied. Now Rule 30 provides :—"Any amount either written off in the accounts or through the Actuarial Valuation Balance Sheet to meet depreciation, or loss on securities or other assets, or which is carried to a reserve fund formed for that sole purpose and not used for any other purpose, may be treated as expenditure incurred solely for the purpose of earning the profits of the business".

In the present case for the first two years there was a depreciation of securities, and amounts to meet that depreciation were carried to a reserve fund formed for that sole purpose and the question is whether the assessee can treat those sums as expenditure incurred solely for the purpose of earning the profits of the business without giving credit for appreciation which occurred in the third year.

The contention of the Commissioner of Income-tax is that the words "may be treated as expenditure" in Rule 30 are permissive and confer an option upon the Income-tax Officer either to allow this expenditure or not. No doubt the word "may" is permissive. But the question is on whom is the permission conferred? It seems to me perfectly plain that it is conferred on the assessee. It may also be conferred on the Income-tax Officer, but that is irrelevant. It seems to me clear that when the rule says that these sums placed to reserve may be treated as an expenditure solely for the purpose of earning the profits of the business, that confers the right on the assessee to treat the sums in that way. The rule is not compulsory

and it is possible that an assessee might refer to pay the income-tax on moneys placed to a special reserve fund so that there would be no difficulty in the future in bringing those sums back into revenue. But I am clearly of opinion that the rule gives permission to the assessee to do what the rule allows, and that it does not merely confer an option upon the Income-tax Officer. These sums having been properly placed to the special reserve fund in the first two years of the triennial period, I can find nothing in the rules which requires that they be brought back into the revenue account as soon as the depreciation which they were designed has been made good. The company may well think that it may have to pass through difficult times again, and that it is prudent to keep its reserve in hand even though the reserve at the moment may not be wanted for the purpose for which it was made.

The Advocate-General says that serious consequences may follow on this interpretation of Rule, because large sums may be placed in reserve on which tax will not be paid. But it is to be noticed that sums placed to the special reserve fund must be in respect of depreciation or loss, which, in my view, means depreciation or loss which has actually occurred, and that reserve fund can be used for no other purpose. These two considerations afford considerable safeguards against the possibility of a company forming excessive reservations under Rule 30 and evading paying taxation. In my view, the finding of fact of the Assistant Commissioner of Income-tax, which is referred to in the question raised, is really irrelevant, and the questions must be answered in the negative.

BLACKWELL, J.—I am of the same opinion.

The contention of the Commissioner of Income-tax is that the words "may be treated" in Rule 30 confer upon him and upon him alone, the option to treat sums written-off to meet depreciation of, or loss on, securities or other assets, or carried to a reserve fund formed for that sole purpose, and not used for any other purpose, as expenditure incurred solely for the purpose of earning the profits of the business. In my opinion this construction does violence to the plain words of the rule. It seems to me that the rule confers an option upon the assessee to write-off in his accounts to meet depreciation or to carry to a reserve fund to meet depreciation any amount which is justified by an actual loss in any particular year. The facts disclosed by the evidence in the present case are that the assessee set aside in the first two years sums much smaller than were sufficient to meet the actual loss which

occurred in those years. The mere fact that there was an appreciation in the securities in the third year seems to me to be entirely irrelevant so far as the construction of Rule 30 is concerned in relation to the first and second years, and if there has been a writing off or setting aside to reserve fund in any particular year justified by the state of accounts of the company of that year, the rule seems to me plainly to permit the assessee to treat the amount so written-off or set aside as expenditure incurred solely for the purpose of earning the profits of the business. There is nothing in this rule to compel the assessee, who has exercised his option to bring back any sums which have been properly set aside by him in accordance with the rule.

I agree, therefore, that the question must be answered in the negative.

Mr. M. C. Setalvad, with *Mr. P. B. Gajendragadkar* for the assessee Company.

Sir Kenneth McI. Kemp, *Advocate-General*, with the *Government Solicitor*, for the Referor.

[IN THE JUDICIAL COMMISSIONER'S COURT OF SIND].

COMMISSIONER OF INCOME-TAX, BOMBAY

v.

LOKUMAL BHOJUMAL.

RUPCHAND, A. J. C.

February 16, 1937.

RE-ASSESSMENT—FALSE RETURN—EVASION OF TAX—DISCOVERY OF FRAUD—POWER TO MAKE FRESH ASSESSMENT UNDER SEC. 34—‘ESCAPE ASSESSMENT’, MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 34.

Where an assessee makes a false return and by misleading the income tax authorities evades income tax, the income tax authorities have power, on finding out that income had been concealed, to take proceedings under Sec. 34 of the Indian Income Tax Act for fresh

assessment. The words 'escape assessment' in Sec. 34 are wide enough to cover such cases.

The assessee made a return for the year 1932-33 showing a loss of Rs. 20,397. The Income Tax Officer, accepting the assessee's accounts and holding that the assessee had suffered a loss of Rs. 19,000 odd, did not levy any income tax. In the course of the assessment for the next year the Income Tax Officer examined the accounts more carefully, found that the profits had been concealed in the books and proceeded to revise his decision for the year 1932-33 under Sec. 34 and to make an assessment of Rs. 15,000 for that year. The question being whether the Income Tax Officer has power to make a fresh assessment under Sec. 34 in such circumstances : Held, that Sec. 34 was wide enough to cover such cases and the proceedings taken under Sec. 34 were valid.

RAJENDRANATH MUKHERJI v. COMMISSIONER OF INCOME TAX, BENGAL [1934] (2 I.T.R. 71; 7 I.T.C. 143; I.L.R. 61 Cal. 285) explained.

AMIR SINGH SHER SINGH v. COMMISSIONER OF INCOME TAX, PUNJAB [1935] (3 I.T.R. 171; 8 I.T.C. 198) and *REX v. BRADBURY* [1920] (37 T.L.R. 88) referred to.

STATEMENT OF CASE.

Case stated under Sec. 66 (2) of the Indian Income Tax Act (hereinafter referred to as the "Act") by the Commissioner of Income Tax, Bombay Presidency and Aden, at the instance of Mr. Lokumal Bhojmal (hereinafter referred to as the "assessee") for favour of decision by the Honourable Court of the Judicial Commissioner of Sind on the question of law set out in paragraph 3 below. The question of law has arisen out of the assessment of the assessee for the year 1932-33 (ended on 31-3-1933).

2. Facts of the Case.—The assessee is a resident of Sukkur within the jurisdiction of the Income Tax Officer, Sukkur, and carries on business in wines, beer, intoxicating drugs such as "bhang" etc. For the purpose of assessing him to income-tax for the year 1932-33 (ended on 31st March 1933), he was called upon by the Income Tax Officer, Sukkur, to declare his income for the preceding year 1931-32 (ended on 31st March 1932), as required by Sec. 22 (2) of the Act. The assessee thereupon put in a return of income on 13th September 1932 declaring therein a loss of Rs. 20,397. After examination of accounts, the Income Tax Officer determined the loss at Rs. 19,227 and exempted the assessee

by his order dated 25-10-1932 a copy of which is annexed hereto marked Exhibit A. Thereafter for the subsequent year 1933-34 (ended on 31st March 1934), the assessee was called upon to put in his return of income and once again he declared a loss of Rs. 12,045 for the year ended 31-3-1933. Accounts were then called for and while examining them, it was found that the capital of the assessee had, in spite of these repeated losses increased substantially. He was made to explain satisfactorily the cause of this increase and further consideration convinced the Income Tax Officer that the said increase was due to concealed profits. He rejected the accounts therefore and assessed the assessee on an estimated income of Rs. 11,000. The assessee appealed against this assessment to the Assistant Commissioner of Income Tax, Sind, whose inquiry at the time of hearing the appeal confirmed the Income Tax Officer's presumption and the assessee, being unable to prove his contentions, actually withdrew his appeal by his application to the Assistant Commissioner of Income Tax, Sind, dated 17-2-1934, thus leaving absolutely no doubt whatever that he had incorrectly declared a loss and had concealed his true income. In view of these proved facts, the Income Tax Officer had reason to believe that the loss declared for the purposes of the assessment for the preceding year 1932-33 was also incorrect and that the true income was concealed by crediting sale receipts direct to the capital account and that it had thus escaped assessment. Hence he started proceedings under Sec. 34 of the Act for the purpose of assessing the income, profits and gains which had escaped assessment because of an incorrect declaration of income by the assessee and because of his having directly credited to his capital account income liable to tax. A notice under Sec. 34 read with Sec. 22 (2) of the Act was thereupon issued on 17-2-1934 calling upon the assessee to put in a fresh return of income from all sources on or before 17-3-1934. (A copy of the said notice is annexed hereto marked Exhibit B). The assessee failed, however, to put in a return of income in time. He was then served with a notice under Sec. 22 (4) of the Act to produce his accounts. He would not, however, appear. The Income Tax Officer, therefore, levied an assessment on an estimated income of Rs. 30,000 under Sec. 23 (4) of the Act on 25-5-1934. (A copy of the Assessment Order is annexed hereto, marked Exhibit C). The assessee finding this to be a very heavy assessment applied under Sec. 27 of the Act for reopening the case. The Income Tax Officer thereupon reopened the case though, really speaking, there were no proper grounds for

doing so. A fresh return of income declaring a loss of Rs. 7,459 only was put in as against the loss of Rs. 20,397 declared previously for the same year. This in itself was sufficient to show what reliance could possibly be placed on an assessee and his accounts when a loss of Rs. 20,397 could be mistaken for a loss of Rs. 7,459 only and *vice versa*. The assessee tried to explain the difference, when pointed out, as due to an oversight about which the less said the better. His accounts were called for and examined and, as expected, a number of cash credits were found in his and other accounts, which he was unable to explain. With such state of affairs, the Income Tax Officer could not at all rely on the accounts produced and he had to make an estimate of the income liable to tax. He accordingly levied tax on an income of Rs. 15,000 under his assessment order dated 4-3-1935, a copy of which is annexed hereto marked Exhibit D. The assessee appealed against this assessment to the Assistant Commissioner of Income Tax, Sind, under his petition of appeal dated 6-3-1935, a copy of which is annexed hereto marked Exhibit E. The Assistant Commissioner, while hearing the appeal re-examined the accounts and found that not only were there several cash credit entries without any satisfactory explanation but that though the assessee was, during the accounts period, a partner in another business from which he had earned as his share Rs. 2,500, he had totally concealed this additional income all throughout the assessment proceedings. As this income, although taxed at source, affected the rate of tax applicable to the assessee, the Assistant Commissioner, after giving due notice, included the said amount in the computation of the total income of the assessee and enhanced the tax levied by the Income Tax Officer at Rs. 1,172-13-0 to Rs. 1,572-8-0, and in addition levied a penalty of Rs. 100 under Sec. 28 of the Act. A copy of this appellate order dated 12-3-1935 is annexed hereto and marked Exhibit F. The assessee thereupon appealed against the enhancement of tax to the Commissioner under Sec. 32 of the Act and also requested him to refer to the High Court under Sec. 66 (2) of the Act certain questions of law arising out of the appellate order of the Assistant Commissioner, (Exhibit H). On a consideration of the appeal, the Commissioner, by his order dated 5-7-1935 (a copy annexed hereto marked Exhibit G) confirmed the enhancement of tax by the Assistant Commissioner. In view of the application for a reference to the Honourable Court, this Statement of the Case has now been drawn up.

3. **Question for the Decision of the Honourable Court.**—The assessee has by his petition dated 13th May 1935 (copy annexed hereto marked Exhibit H) required the Commissioner to refer the following two questions:—

“1. Whether the assessment in this case is in accordance with the provisions of Sec. 34 of the Act?

2. Whether the assessment is valid within the provisions of Sec. 13 of the Act for the following reasons:

(a) Whether the method of accounting is such as can clearly reflect the income, profit or gain of the previous year and whether it is one usually adopted by the petitioner and accepted in the last?

(b) Whether the assessment is made on proper basis as required by proviso to Sec. 13?”

The Commissioner refers to the Honourable Court for decision only question (1), as question (2) cannot arise in a case in which the finding of fact is that the accounts put in are unreliable and made up to disclose a loss by taking items of profit not to the profit and loss account but directly to other accounts. There is no question of method of accountancy in this case and the reference to Sec. 13 is incorrect. The estimate of the income framed by the Income-tax Officer is in virtue of his powers under Sec. 23 (3) of the Act.

4. **Opinion of the Commissioner.**—As Sec. 66 (2) of the Act requires the Commissioner to give his opinion while submitting this Statement of the Case, he begs to submit that in his opinion the answer to the question raised should be in the affirmative. The argument of the assessee appears to be that the Income-tax Officer levied the second assessment on the same facts as he had before him at the time of the original assessment when he exempted him. While the appeal was being heard by the Assistant Commissioner, he (the Assessee) argued that “on the same facts, however, an estimate is now made, which has not the sanction of any fresh facts”. This argument is not correct as will be seen from the facts stated in paragraph 2 above. At the time of the first assessment, the Income-tax Officer had not before him the facts which he has in his possession at the time of the second assessment to show that the accounts put in were unreliable. Also the considered judgment of the Lahore High Court in the matter of *Amirsingh Sher Singh v. The Commissioner of Income Tax, Punjab and N. W. F. Provinces* (Income Tax Reports by Aiyar, Volume III, page 171) to which attention is respectfully invited, leaves no

doubt as to the correctness of the assessment in dispute, even on the assumption that the facts were the same. The above Honourable Court in its judgment lays down that "The words 'for any reason' placed before the expression 'escaped assessment' (in Sec. 34 of the Act) clearly indicate that the Legislature intended to include all those cases, which either resulted from mere inadvertence or from conscious misapprehension of the proper position." The Commissioner entirely agrees with this interpretation of Sec. 34 of the Act and begs to add that there cannot be a better case for being dealt with under Sec. 34 than this in which, by putting in unreliable accounts, an assessee escaped assessment at the time of the original assessment proceedings.

5. A copy of the judgment of the Honourable Court may be certified to the Commissioner as required by Sec. 66 (5) of the Act.

Partabrai D. Punwani for the Commissioner.

Dipchand Chandumal for the Assessee.

JUDGMENT.

RUPCHAND, A. J. C.—This is a reference under Sec. 66, Clause (2), of the Income Tax Act. The facts giving rise to it are as follows:

The assessee made a return for the year 1932-33 showing that he had suffered a net loss of Rs. 20,307 during the previous year ending with 31st March 1932. The Income Tax Officer examined the account books of the assessee and held that the assessee had suffered a loss of Rs. 19,227 during that year. He accordingly passed an order dated October 25, 1932, exempting the assessee from income-tax for the year 1932-33.

The assessee made a return for the following year, that is, for the year 1933-34, and showed that he had again suffered a loss of Rs. 12,045 for the year ending with March 31, 1933. This time the Income Tax Officer examined the account with greater care and discovered that notwithstanding the alleged loss sustained by the assessee for two succeeding years, the account books showed a substantial increase in the capital invested by the assessee in the business which the assessee could not satisfactorily account for. He came to the conclusion that the real profits made by the assessee from his business had been concealed by making false entries in the account books, and accordingly rejected the account books of the assessee and taxed him on an income of Rs. 11,000 calculated upon a certain percentage basis on the turnover.

The assessee filed an appeal against that order, but subsequently withdrew it. The Income-tax Officer then proceeded to revise the decision given by him exempting the assessee from income tax for the year 1932-33. He purported to do this by taking proceedings under Sec. 34 of the Act. On February 17, 1934, that is to say, within the period of one year prescribed by that Section for taking action, he called upon the assessee to make a fresh return for that year. The assessee avoided submitting a return during the time allowed to him by the notice, and was assessed on an income of Rs. 80,000. He then submitted a return showing a loss of Rs. 7,459 as against the loss of Rs. 20,397 previously shown by him in his first return. The Income-tax Officer then again went into the question and fixed the income of the assessee at Rs. 15,000. He did this because he thought that certain credit entries were falsely entered as cash received.

On appeal the Assistant Commissioner of Income-tax did not disturb the finding of the Income-tax Officer as to the total profit which the assessee was supposed to have made in his business, but as a part of this profit had been made by the assessee from a separate business in which he was a partner and which fact had been suppressed, the Assistant Commissioner of Income-tax increased the incidence of taxation on that profit and in addition levied a fine of Rs. 100 on him for suppressing that fact.

The assessee then applied in revision to the Commissioner of Income-tax and on obtaining no relief from him asked for a reference to this court upon the following questions :

(1) Whether the assessment in this case is in accordance with the provisions of Sec. 34 of the Act?

(2) Whether the assessment is valid with the provisions of Sec. 13 of the Act for the following reasons:—

(a) Whether the method of accounting is such as can clearly reflect the income, profit or gain of the previous year and whether it is the one usually adopted by the petitioner and accepted in the past?

(b) Whether the assessment is made on proper basis as required by proviso to Sec. 13?

The learned Commissioner of Income-tax has referred only the first question to us, he being of the opinion that the second question was under the circumstances of the present case a question of fact and not a question of law.

Now, there can be no doubt that on the merits the assessee has no case whatsoever. It is however argued on his behalf that

as he had been assessed once and was held to have suffered a loss and therefore not liable to pay income-tax for that year, he could not, in law, be re-assessed by the Income-tax Officer by resorting to the provisions of Sec. 34 of the Act, and that, in any case, he could not be re-assessed on a profit of Rs. 15,000. We are afraid there is no substance in these contentions.

The words of Sec. 34 are very wide and *inter alia* provide that when an income has escaped assessment, whatsoever be the reasons, proceedings may be taken against the assessee under that section within the prescribed period. Under the corresponding Section of the English Act, which is Sec. 125, an Inspector is entitled to take proceedings against an assessee if he discovers (1) that any property or profit chargeable to tax have been omitted from the first assessment, or (2) that a person chargeable has not delivered a full and proper statement, (3) that a person has not been assessed to tax, or (4) that a person has been undercharged on the first assessment, or (5) that a person has been allowed or has obtained from the first assessment any allowance, deduction exemption, abatement, or relief not authorized by the Act.

The procedure laid down in that section is somewhat different from that laid down in the present section. But there can be no doubt that the present section is intended to cover within its ambit all cases referred to above.

In the present case, the assessee evaded his liability to pay the tax by making a return which did not contain a full and proper or true statement of his accounts, and thus escaped assessment.

Considerable reliance has been placed by Mr. Dipchand on the observations of their Lordships of the Privy Council in *Rajendra Nath Mukerjee and others v. Commissioner of Incometax, Bengal*, where it is said :—

“The appellants, however, submit that this is a case of income, escaping assessment within the meaning of Sec. 34. Assessment, they argue, is a definite act, indeed the most critical act in the process of taxation. If an assessment is not made on income within the tax year then that income, they submit, has escaped assessment within that year, and can be subsequently assessed only under Sec. 34 within its time limitation. This involves reading the expression ‘has escaped assessment’ as equivalent to ‘has not been assessed’. Their Lordships cannot assent to this reading. It gives too narrow a meaning to the word ‘assessment’ and too wide a meaning to the word ‘escaped’. That the word ‘assessment’ is

not confined in the statute to the definite act of making in order of assessment appears from Sec. 66 which refers to the course of any assessment'. To say that the income of Burn & Co. which in January 1928 was returned for assessment and which was accepted as correctly returned, though it was erroneously included in the assessment of Martin & Co., has 'escaped' assessment in 1927-28 seems to their Lordships an inadmissible reading. The fact that Sec. 34 requires a notice to be served calling for a return of income which has escaped assessment strongly suggests that income which has already been duly returned for assessment cannot be said to have 'escaped' assessment."

But these observations do not apply to the present case. In the case referred to above Messrs. Burn & Co., had made a true return of their income. They had not been assessed to income-tax because the Income Tax Officer thought that the income was an income for which Messrs. Martin & Co., should be assessed, and he had accordingly added that income to the income returned by Messrs. Martin & Co. In doing so he was wrong, and when after his decision was set aside and Messrs. Burn & Co., were being assessed, they raised the plea that as the period of limitation contained in Sec. 34 has expired, they could not be assessed. Under those circumstances the fact that no assessment was made on the income of Messrs. Burn & Co., could not possibly be said to indicate that the said income has escaped assessment. Messrs. Burn & Co., had made no attempt to evade their income being assessed, and as a matter of fact that income had not only not escaped assessment, but had been assessed although against a wrong party.

Our attention has also been invited to the rulings of some of the Indian High Courts in which the words 'escaped assessment' have been given a much more limited meaning than that indicated by the words themselves. All those rulings have been referred to and discussed in the case of *Messrs. Amirsingh Sher Singh v. The Commissioner of Income Tax, Punjab, N.W.F. and Delhi Provinces* and it has been rightly pointed out there that those rulings have not given due effect to the words 'for any reason' which appear in the section.

It is rather unfortunate that Sec. 34, unlike the corresponding section of the English Act, does not specifically refer to the cases in which the Income Tax Officer may take action, and the words 'escaped assessment' are some what vague and indefinite; but reading the section as a whole, we have no hesitation in

holding that the facts of the present case do come both within the meaning and spirit of the section. The income of the assessee has certainly escaped assessment by the simple process of a false return having been filed, and the fraud perpetrated by him was not detected at the commencement. As the fraud was detected within the time limit prescribed by the section, it is not necessary for us to consider the dictum of LORD READING, C.J., in *Rez v. Bradbury* which supports the proposition that in cases of fraud the Crown is not prevented by such a time limit from recovering a tax, nor is it necessary for us to go into the further question whether the assessee is not liable to be assessed under any other provision of the Act.

For these reasons we answer the first question which is the only question referred to us by the learned Commissioner in the affirmative.

With regard to the second question propounded by the assessee we agree with the learned Commissioner that that question is in the circumstances of the present case one of fact and not of law and we hold accordingly. It is no doubt true that the unexplained items discovered by the Income Tax Officer amounted only to Rs. 15,000 and it was no doubt open to argument that if these items were transferred to the account of sale proceeds, the loss of Rs. 7,000 odd as shown by the assessee in his second return would disappear and his profit would amount to Rs. 8,000 and not Rs. 15,000. But on appeal the Assistant Commissioner of Income Tax discovered another very big item of Rs. 21,000. The explanation of the assessee with regard to that item also was not accepted specially in view of the fact that the account books of that particular concern from which according to the assessee he had received Rs. 21,000 were not produced. If this item were added to the items discovered by the Income Tax Officer the profit of Rs. 15,000 for which income tax has been levied from him is in no sense excessive. It would, therefore, appear that the assessee has rather been lightly dealt with and has not been made to pay more than what would be his estimated profit. There is, therefore, no substance in the argument that the income of the assessee should have been fixed on percentage basis on the turn over as was done in the next year.

Under the circumstances it is not necessary for us to go into the further question whether or not it is open to the assessee to raise a point on which the Income Tax Commissioner has refused to submit a case in the absence of his having applied to this court

under Sec. 66, Clause 3, to compel the Commissioner to state a case upon this point within the time allowed by law.

In the course of his arguments the learned Advocate raised a third point and that was that the Assistant Commissioner of Income-tax had no power to increase the incidence of income-tax on Rs. 2,500 or to impose a penalty of Rs. 100 on the assessee. But we are afraid it is not open to the learned Advocate to raise new points not raised by him before the Commissioner at the proper time and that also without even giving previous notice to the Government pleader, and therefore we decline to go into that question.

The Income-tax Commissioner will have costs of this reference which will be taxed in the ordinary course.

Answered accordingly.

[IN THE PRIVY COUNCIL].

COMMISSIONER OF INCOME-TAX, PUNJAB AND N.W.F.P.

v.

NAWAL KISHORE KHARAITI LAL.

LORD THANKERTON, SIR SHADI LAL, SIR GEORGE RANKIN.

November 9, 1937.

NON-RESIDENT—ASSESSMENT OF AGENT—ORDER DECLARING INTENTION TO TREAT ASSESSEE AS AGENT—WHETHER CONDITION PRECEDENT TO INITIATION OF PROCEEDINGS—NOTICE BEFORE SUCH DECLARATION—VALIDITY—NOTICE UNDER SEC. 43 NOT SPECIFYING YEAR OF ASSESSMENT—VALIDITY—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 42, 43, 22 (2).

Under the Indian Income-tax Act it is not necessary to the validity of a notice calling for a return of income under Sec. 23 (2), where it is served upon a person as agent of a non-resident under Sec. 43, that it should have been preceded not only by the notice of the intention prescribed by Sec. 43 and by the opportunity of being heard prescribed by the proviso thereto, but also by an order declaring the person to be the agent of the non-resident person or treating him as such agent. It is open to the Income-tax Officer under the Act to postpone any final determination of the question of agency until the time comes to make an assessment under Sec. 23 of the Act.

Proceedings if begun in time are not under the Act required to be completed within any time limit.

The notice under Sec. 43 is a part of the series of facts which results in the resident being deemed agent by force of the section, and if by a notice given in due course under Sec. 22 (2) the year or years be specified, he can have no grievance in point of procedure merely because the year for which he was proposed to be treated as an agent was not mentioned in the notice under Sec. 43. An assessment made on a person as agent of a non-resident is not therefore illegal by the fact that the notice which the Income tax Officer served on him under the proviso to Sec. 43 did not mention any particular year for which the Income-tax Officer proposed to treat him as an agent.

Appeal from a judgment of the High Court of Lahore reported at pp. 350 to 357 of Vol. III of the *Income-tax Reports*.

A. M. Dunne and Hubert Hull for the Appellant.

L. DeGruyther and S. Hyam, for the Respondent.

JUDGMENT.

SIR GEORGE RANKIN.—This appeal is brought from a decision of the High Court at Lahore by the Commissioner of Income-tax Punjab, North-West Frontier and Delhi Provinces. On 8th June 1921, the Income-tax Officer at Delhi made an order under Sec. 23 sub-sec. 3, read with Sec. 34, Indian Income-tax Act 1922, whereby for the year of assessment, 1926-27, he assessed the respondent firm upon a 'total income' of Rs. 72,928 and determined that the tax payable thereon was Rs. 6,837. This assessment order was made upon the respondent firm whose name and style is Nawal Kishore Kharaiti Lal and who carry on business as jewellers at Delhi, but it was made upon them as agent for a Hindu undivided family resident in the State of Jaipur outside British India. One Seth Banji Lal had been head of this family, but had died in December 1928.

The validity of this assessment order is in substance the matter in dispute between the parties, but the case comes before their Lordships as an appeal by special leave from the judgment of the High Court upon a reference made under Sec. 66 of the Act formulating three questions of law for the High Court's decision. As these questions challenge the procedure adopted by the Income-tax authorities, it will be convenient to state first the steps which they had taken and then the objections raised by the respondent firm. Secs. 34, 42 (1) and 43 of the Act are the provisions of chief importance in the case:

34.—“If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year, or has been assessed at too low a rate, the Income-tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-sec. (2) of Sec. 22 and may proceed to assess or re-assess such income, profits or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section :

“Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be.”

42 (1)—“In the case of any person residing out of British India, all profits or gains accruing or arising, to such person, whether directly or indirectly, through or from any business connexion or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to income-tax in the name of the agent of any such person, and such agent shall be deemed to be, for all the purposes of the Act, the assessee in respect of such income-tax :

Provided that any arrears of tax may be recovered also in accordance with the provisions of this Act, from any assets of the non-resident person which are, or may at any time come within British India.”

43. “Any person employed by or on behalf of a person residing out of British India, or having any business connexion with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income-tax Officer has caused a notice to be served of his intention of treating him as the agent of the non-resident person shall, for all the purposes of this Act, be deemed to be such agent :

Provided that no person shall be deemed to be the agent of a non-resident person, unless he has had an opportunity of being heard by the Income-tax Officer as to his liability.”

On 2nd February 1928, the Income-tax Officer served the respondent firm with a notice in the following terms :

“You are hereby required to attend this Court on 9th February 1918, and show cause why you should not be treated as agents of Seth Banji Lal of Jaipur State for income-tax assessment purposes.”

This notice did not specify any particular year of assessment. It was headed "Notice under Proviso to Sec. 43, Income-tax Act of 1922". On 13th February the Income-tax Officer recorded as follows :

Mr. Charter Behari Lal present Heard Sec. 22 (2) notice with necessary forms served on him for 1926-27 (Sec. 34) and 1927-28 for Nawal Kishore Kharaiti Lal, agent of S. Banji Lal.

The respondent firm on 12th March filed a bank return under protest and lodged a petition of appeal against the order of 13th February before the Assistant Commissioner. This appeal, which purported to be brought under Sec. 30 of the Act, was not in their Lordships' view within the terms of that section, but the Assistant Commissioner did not dismiss it on that ground. He considered, as their Lordships read his order of 2nd May 1928, that the Income-tax Officer's order of 13th February did not purport to decide that the respondent firm were agents of Seth Banji Lal. About a year later, namely on 5th April 1929 a notice under Sec. 23 (2) of the Act was sent to the respondent firm as agent for Seth Banji Lal requiring them to attend at the Income-tax Officer's Office and to produce evidence in support of the return which they had rendered. This notice specified the year 1926-27 as well as 1927-28. Nothing appears to have been done under this notice for two years afterwards, a fact which may be explained by the circumstance that the assessment in respect of previous years was being disputed. On 5th May 1931, however, two things happened. The respondent firm filed a fresh return in respect of the year 1926-27 showing a sum of Rs. 51,550 as interest on loans payable by them to Seth Banji Lal of Jaipur. The Income-tax Officer on the same date served a notice on the respondent firm stating that it was proposed to treat them as the agent of Seth Banji Lal for the year 1926-27. 8th May 1931 having been appointed for hearing any objections to this course, the Income-tax Officer on that date recorded an order against the respondent firm as follows :

They pay interest to the non-resident on his deposits with them. The non-resident has thus business connexion with them and is in receipt of income through them. I accordingly hold them as agent for Seth Banji Lal of Jaipur under Sec. 43 for the assessment for 1926-27.

The assessment order of 8th June 1931, included, besides the sum of Rs. 51,550 admitted to be payable by the respondent firm, two other items of interest payable by other persons of Seth Banji Lal, bringing the "total income" to the figure of Rs. 72,928

already mentioned. An appeal to the Assistant Commissioner having been dismissed on 19th August 1931, application was made to the Commissioner under Sec. 66 of the Act to state a case to the High Court. On 14th May 1932, the Commissioner referred to the High Court three questions as follows :

“(1) Whether in the circumstances of this case, the petitioner could be held to be an agent for Seth Banji Lal within the meaning of Sec. 43 ? (2) Whether the assessment made on the firm of Nawal Kishore Kharaiti Lal of Delhi (the petitioner) as agent of Seth Banji Lal of Jaipur under Sec. 43 is rendered illegal by the fact that the notice which the Income-tax Officer served on the firm under the Proviso to Sec. 43 did not mention any particular year for which the Income-tax Officer proposed to treat the firm as an agent. (3) Whether proceedings could be started under Sec. 34 of the Act against the petitioner as agent of the non-resident in view of the fact that action under that section was time-barred, more than one year having lapsed since the issue of the notice, dated 2nd February 1928 ? ”

As required by the Act, the Commissioner gave his opinion on each question, answering each against the respondent firm namely (1) Yes : (2) No : (3) Yes : The High Court (ADDISON AND SALE, JJ.) answered the first and third questions in the negative and held that the second question did not arise. Their view was that the Assistant Commissioner, having by his order of 2nd May 1928, held that no order had been passed declaring the respondent firm to be the agent of the non-resident, the income-tax authorities were bound by that opinion. On this footing there was no order declaring the respondent firm to be such agent until 8th May 1931. No such order having been passed before 13th February 1928, the notice of that date calling for a return of income under Sec. 22 (2) was in the opinion of the learned Judges invalid, and as this was the only notice ever served under that sub-section, the assessment was illegal as well as out of time under Sec. 34. They concluded their judgment by saying :

“The result of this reference is that the petitioner will escape assessment of income-tax for the year 1926-27 on a technicality.”

The first question for decision is whether by the terms of the Act it is necessary to the validity of a notice calling for a return of income under Sec. 25 (2) where it is served upon a person as agent of a non-resident under Sec. 43, that it should have been preceded, not only by the notice of intention prescribed by Sec. 42 and by the opportunity of being heard prescribed by the proviso thereto, but

also by an order to the effect variously described by the High Court as "declaring the petitioner to be the agent of a non-resident person" and "treating him as such agent". It may be reasonable that *A* should not be required to render a return of *B*'s income until it has first been decided that he is agent of *B*: on the other hand, having regard to the circumstances which for this purpose constitute agency, it may well be thought advisable that the information afforded by a return and by books of account produced in support thereof should be available for the purpose of deciding as to agency. The avoidance of delay may also be a consideration. The matter must be determined entirely upon the language of the Act, and their Lordships cannot find that it imposes the technical requirements upon which the High Court have insisted. It seems to their Lordships to be open to the Income-tax Officer under the Act to postpone any final determination of the question of agency until the time comes to make an assessment under Sec. 23 of the Act. The notice of 13th February 1928 was served before the expiry of one year from the end of the financial year 1926-27. Subject therefore to the merits of the case and to the answer to be given to the second of the three questions referred, the notice of 13th February was a valid initiation of proceedings to assess the respondent firm as an agent under Sec. 43 and in respect of the year of assessment 1926-27. Proceedings if begun in time are not by the Act required to be completed within any time limit.

The objection taken by the second question is that the notice of 2nd February 1928 did not specify the year 1926-27 though this was done by the notice of 13th February requiring returns to be made under Sec. 22 (2). It would appear that in 1931 the then Income-tax Officer had some doubt upon this point, and that the issue of a second notice on 5th May 1931 specifying 1926-27 was intended to meet the difficulty. If, however, the original notice of 2nd February 1928, had been for this reason bad, that of May 1931 was much too late to take its place or cure it. The High Court did not think it necessary to answer the second question referred to them, but in their Lordships' view it should be answered, and the answer is in the negative. The notice is by Sec. 43 made part of the series of facts which results in the resident being deemed agent by force of the section. The extent of his responsibility if he be agent, is another matter. If by notice given in due course, under Sec. 22 (2) the year or years be specified he has no grievance in point of procedure and he can make his case upon the merits.

No question of law arises upon the controversy as to agency. At the hearing it was desired by learned counsel for the respondent firm to contend that his clients should not have been assessed upon the figure of Rs. 72,928, which includes interest payable to the non-resident by third parties in British India, but only upon the figure of Rs. 51,550 which was payable by the respondent firm. No such issue can be brought within any of the three questions referred by the Commissioner to the High Court nor has it been discussed at any previous stage of the reference. Their Lordships are accordingly unable to entertain it. They will humbly advise His Majesty that this appeal should be allowed, that the judgment of the High Court be reversed and that in lieu of the answers given by the High Court to the three questions referred to them by the Commissioner, the following answers be respectively given namely question (1) : Yes ; Question (2) : No ; Question (3) Yes. The respondent firm will pay the appellant's costs of this appeal and of the reference in the High Court.

Appeal allowed.

[IN THE HOUSE OF LORDS].

EATON-TURNER

v.

MCKENNA (INSPECTOR OF TAXES).

LORD ATKIN, LORD THANKERTON, LORD RUSSELL OF KILLOWEN,
LORD MACMILLAN, LORD ROCHE.

October 15, 1936.

INCOME TAX AND SURTAX—TAXPAYER RESIDENT IN ENGLAND
—EMPLOYMENT PARTIALLY ABROAD—LIABILITY IN RESPECT OF
SALARY—SALARY PAID IN ENGLAND—INCOME TAX ACT, 1918 (8 &
9 GEO. 5. c. 40), s. 1, SCHED. D, para. 1 (a) (ii) ; SCHED. E, RULES
APPLICABLE TO SCHED. E, r. 6—FINANCE ACT, 1922 (12 & 13
GEO. 5, c. 17), s. 18.

*A person resident in England, but employed in West Africa by
an English company controlling their business from England : Held,
chargeable with income tax under Schedule E in respect of the
emoluments of his employment, which were paid to him for the most*

part in England, the facts falling within Case II of Schedule D, transferred to Schedule E by Sec. 18 of the Finance Act, 1922—See Schedule D, clause 1 (a) (ii).

COLQUHOUN *v.* BROOKS [1889] (59 L.J.Q.B. 53; 14 App. Cas. 493; 2 Tax. Cas. 490) *distinguished*.

FOULSHAM *v.* PICKLES [1929] (94 L.J.K.B. 418; [1925] A.C. 458; 9 Tax. Cas. 261) *followed*.

Decision of the COURT OF APPEAL [1936] (105 L.J.K.B. 246; [1936] 1 K.B. 1) *affirmed*.

Cases referred to :

COLQUHOUN *v.* BROOKS [1889] (59 L.J.Q.B. 53; 14 App. Cas. 493; 2 Tax. Cas. 490).

FOULSHAM *v.* PICKLES [1925] (94 L.J.K.B. 418; [1925] A.C. 458; 9 Tax. Cas. 261).

Appeal from the decision of the Court of Appeal.

The facts are shortly set out in the judgment of Lord Atkin and will be found fully stated in the report in 105 L.J.K.B. 246.

Needham, K.C., and Cyril L. King, for the appellant.

The Attorney-General (Sir Donald B. Somervell, K.C.) and Reginald P. Hills, for the respondent, were not called upon to argue.

The argument for the appellant is sufficiently outlined in the judgment of Lord Atkin.

LORD ATKIN.—This is an appeal from an order of the Court of Appeal which dismissed an appeal by the appellant from an order of Singleton, J. Singleton, J. had allowed an appeal by the Crown on a case stated by the special commissioners, who had decided in favour of the appellant. There are several assessments in question in respect of years beginning with the year 1926-27 and ending with the year 1931-32.

The appellant was employed by the Ashanti Goldfields Corporation, Ltd., as their manager. He began as assistant manager, and he was employed under written contracts under which his duties as far as he was concerned were, as found by the special commissioners, to be wholly performed outside the United Kingdom, namely, in West Africa. A condition of the contracts was that payments were to be made as he directed, and he did in fact direct that payments should be made in this country. The greater part of the payments were, therefore, in fact made by his employers to him in this country; but for the purposes of this case,

in the view which your Lordships are taking of it, that, I think, is probably irrelevant.

The appellant is assessed under Schedule E, and he is assessed under that schedule by reason of a provision in the Finance Act, 1922, which, by Sec. 18 (1), provides: "Such profits or gains arising or accruing to any person from an office, employment or pension as are, under the Income-tax Act, 1918, chargeable to income-tax under Schedule D" (other than certain exceptions) "shall cease to be chargeable under that Schedule and shall be chargeable to tax under Schedule E, and the Rules applicable to that Schedule shall apply accordingly subject to the provisions of this Act". Therefore the question which arises is whether or not these profits or gains were profits or gains which would be chargeable to income-tax under Schedule D of the Act of 1918. Sec. 1 of the Act of 1918 provides: "Where any Act enacts that income tax shall be charged for any year at any rate, the tax at the rate shall be charged for that year in respect of all property, profits, or gains respectively described or comprised in the Schedules marked A, B, C, D and E, contained in the First Schedule to this Act and in accordance with the Rules respectively applicable to those Schedules". Then one comes to Schedule D, which provides as follows, by paragraph 1: "Tax under this Schedule shall be charged in respect of:—(a) The annual profits or gains arising or accruing:—(i) to any person residing in the United Kingdom from any kind of property whatever, whether situated in the United Kingdom or elsewhere; and (ii) to any person residing in the United Kingdom from any trade, profession, employment or vocation, whether the same be respectively carried on in the United Kingdom or elsewhere". Then by paragraph 2, it is provided that: "Tax under this Schedule shall be charged under the following Cases respectively; that is to say: . . . Case II. Tax in respect of any profession, employment, or vocation not contained in any other Schedule". The reference there is, no doubt, to employments of a public nature which were originally taxed under Schedule E.

The appellant in this case has carried on his employment outside the United Kingdom, and upon the finding of the commissioners exclusively outside the United Kingdom and he says that he is not properly taxable under Schedule D, or at any rate not under Schedule D, Case II, in respect of profits or gains arising from the employment; and he says that he is not so chargeable because his employment was not an

employment within the United Kingdom, but was an employment exclusively outside the United Kingdom. The answer to that is obvious on the plain statement of the words, because the Act says that tax shall be charged "to any person residing in the United Kingdom from any trade, profession, employment or vocation whether the same be respectively carried on in the United Kingdom or elsewhere"; and the appellant was, as is found, resident in the United Kingdom during the whole of this period. It would, therefore look as though there were a very heavy onus on the appellant to show why he should not be charged in accordance with what would seem to be the plain meaning of the Act. But he says he can show that, because he says that the words in paragraph 1 (a) (ii) of Schedule D (which relates to any person residing in the United Kingdom, "from any trade, whether carried on in the United Kingdom or elsewhere", were considered in the well-known case of *Colquhoun v. Brooks*. In that case, Mr. Brooks resided in the United Kingdom, and he derived profits from a trade which was carried on in Australia, in which he was a partner. It was held that he could not be assessed upon the whole of the profits arising from that trade, but only from so much as was remitted to this kingdom. The appellant here says, by analogy, that inasmuch as the House of Lords, affirming the Court of Appeal, decided that you must put a limit on those extensive words in respect of trade, so you must put a limit on the words in respect of employment. That has involved a consideration of the case of *Colquhoun v. Brooks*.

When that case is looked at, it is plain from the language of the learned members of this House who delivered opinions that the principle upon which they went was this. They all of them pointed out that the appellant was obviously within the meaning of the charging words, but they pointed out also that general words of that kind might have to be cut down, because you cannot construe the general words in one part of a section or one part of an Act without having regard to all that is contained in the Act, and they pointed to a series of considerations which led them to the view that in respect of trade these words ought to be cut down. They first of all pointed out that the machinery was defective, and hopelessly defective, for charging a person in respect of a trade which was carried on wholly abroad. Lord Macnaghten says (59 L.J.Q.B. at p. 64; 14 App. Cas., at p. 515): "When one tries to apply the rules and provisions of the Act relating to profits and gains from trades to a trade carried on exclusively abroad one gets into hopeless

difficulties." He then pointed out that in respect of partnership business the return had to be made by the senior partner resident in Great Britain, and that the return bound all the other partners, and no other partner could make a separate return at all. He pointed out that the computation of the duty was to be exclusive of profits arising from lands occupied, a rule which would be very difficult to apply to a trade carried on abroad. He also pointed out that every person engaged in trade was chargeable by the commissioners acting for the parish or place where the trade was carried on, and that was obviously inapplicable to a case where the trade was carried on in Australia. Then, and conclusively in the view of the learned Lords, they came to the conclusion that the particular profits were really charged under Case V, which deals with tax in respect of income arising from possession out of the United Kingdom; and having found that the machinery was inapplicable to a trader who derived profits here from trade carried on abroad, and having found that there was a case which expressly charged him in respect of his interests in that trade abroad, they came to the conclusion that there was sufficient ground, and clear ground, for cutting down those general words. That decision has been followed ever since, and neither this House nor any member of this House is likely to say anything in criticism of that decision.

But how does that reasoning apply to the present case? We have sought to extract from counsel for the appellant, who have, as usual, said everything that could be said on behalf of their client, some statement of what are the provisions in the present Act which would appear to be inconsistent with the intention to charge the holder of an employment in respect of an employment which was exercised abroad; and there are none. The provision about machinery does not apply. There was a time when it did, and when this Schedule was first passed no doubt there would have been, or might have been a difficulty in charging a person in respect of profits derived from an employment which was carried on abroad, because the person would have to be assessed at the place where the business or employment was in fact conducted. But that was remedied as long ago as 1915, and there is now no such difficulty. And while it is perfectly true that a deficiency in the machinery for collection is an element to be taken into account when you are construing an Act of Parliament and trying to see whether you are to give words their plain meaning, or whether you are to cut them down, at the same time it is by no means conclusive. There may very well be cases where there was an

intention to charge but where the Legislature have failed, through some neglect or improvidence, to provide the necessary machinery. The machinery has now been provided, and in the Act of Parliament as now passed there is no difficulty at all about the machinery. But the other and conclusive element in *Colquhoun v. Brooks* is entirely lacking. There is no Case at all to which this matter can be referred. In *Colquhoun v. Brooks* it was the Case dealing with foreign possessions which induced the members of the House of Lords to say that there was a Case applicable to the matters before them, and therefore the mere general words were not to be relied on, but in the present case it is sufficient to say that by common consent this is not a case of a foreign possession.

I need not discuss the case of *Foulsham v. Pickles* which was decided by this House, and which expressly held that an employment exactly on all fours with the employment here could not be said to be a "foreign possession"; therefore I do not discuss any difficulties that might arise from the conception of an employment being a "possession" at all. Therefore, inasmuch as there is no difficulty about the machinery, and there is no alternative case, and the words are absolutely clear on the face of them and as wide as they can be, and expressly refer to employment outside this country as well as employment within the country, I for my part find insuperable difficulty in seeing that the appellant here ought to succeed in his contention that he has shown that the wide words of the Act are necessarily to be cut down.

There is one other matter that arises on the case. It is said that Sec. 18 of the Finance Act, 1922, which I have read, transfers the profits or gains chargeable under Schedule D to Schedule E, and says that the Rules applicable to that Schedule shall apply accordingly; and then it is said that when you look at the Rules applicable to Schedule E you will find rule 6, which says that "the tax shall be paid in respect of all public offices and employments of profit within the United Kingdom," and therefore it is said that those Rules cannot apply, and that Schedule E cannot apply, and although you may have transferred this employment from Schedule D to Schedule E, you have not found a home for it in Schedule E, and it must wander between earth and heaven because apparently it is not in Schedule D, neither is it in Schedule E.

I think that is much too technical a view, and an incorrect view of the construction. I think the Rules of Schedule E are intended to be applied so far as they are applicable. Once you have found, as I venture to think your Lordships must find, that

this particular profit was chargeable under Schedule D, then I think it is transferred to Schedule E, and the assessment is properly made in those circumstances. Therefore I think that the opinions of the learned Judges below, which I think express exactly the view which I have put before your Lordships, were right, and I suggest to your Lordships that the appeal should be dismissed.

LORD THANKERTON.—I concur in the reasons which have just been given by my noble and learned friend on the Woolsack and also in the conclusions at which he has arrived, and I have very little to add.

The main argument of the appellant in this case is based on the decision of the case of *Colquhoun v. Brooks* but when properly examined it appears to me that *Colquhoun v. Brooks* really is sufficient to decide the case against the appellant, and for these reasons. *Colquhoun v. Brooks* was a case first of all of a trade, and a trade carried on exclusively in Australia. This is the case of an employment; but in that respect I doubt whether there is so much distinction as regards the argument. But, secondly, in *Colquhoun v. Brooks* it was held by this House that the case could possibly fall under Case V, and it is expressly conceded in the present case that it cannot fall under Case V. That is distinction No. 1. Further, in *Colquhoun v. Brooks*, this House, as expressed in the opinions which were delivered, was very clearly of opinion that the language of Case I was apt to cover the case there unless on a consideration of the whole provisions of the statute there were reasons found why the full meaning should not be attributed to Case I; and their Lordships then went on to consider the other provisions. Both Lord Herschell and Lord Macnaghten gave three reasons, and the same three reasons, why a more limited construction should be applied to Case I, and Case V should be preferred. As my noble and learned friend has pointed out, not one of those three reasons applies in the present case. The first two reasons, which were founded on the fact that it was a trade with a partnership, do not apply to an employment at all, and the third reason, which related to the place at which the person might be assessed, has been superseded as regards the present case, not, as assumed by the judgments in the Court of Appeal, by the provision of Miscellaneous Rule 4 applicable to Schedule D, sub-sec. 1 (b), but by Rule 18, sub-sec. 5 of the Schedule E Rules. That, however, is a mere matter of detail: both these Rules were amended by the Finance (No. 2) Act, 1935, Sec. 32, at the same time and in the same section.

That being the case, it does seem to me that the initial view of their Lordships in *Colquhoun v. Brooks*, namely, that you must give effect to the clear words of the Case—in this case Case II and not Case I—unless you find reasons elsewhere in the statute for a more limited construction, applies in the present case, and that no adequate reason has been produced in the present case for applying that more limited construction. Consequently I agree with the conclusion at which my noble and learned friend on the Wool-sack has arrived. On the second point, as to the construction of Sec. 18 of the Act of 1922, I have nothing to add.

LORD RUSSELL OF KILLOWEN.—I agree with the motion proposed, and I have nothing to add.

LORD MACMILLAN.—I also agree.

LORD ROCHE.—I also agree.

Appeal dismissed.

[IN THE COURT OF APPEAL].

NATIONAL MORTGAGE & AGENCY CO. OF NEW ZEALAND
v.

INLAND REVENUE COMMISSIONERS.

LORD WRIGHT, M. R., ROMER, L. J., GREENE, L. J.

January 25, 26, 27, 28, February 11, 1937.

INCOME-TAX—COMPANY CONTROLLED IN UNITED KINGDOM—
CARRYING ON BUSINESS IN DOMINION—RELIEF IN RESPECT OF
DOMINION INCOME TAX—FINANCE ACT, 1920 (10 and 11 Geo, 5. c. 18) Sec. 27 (1).

When a company controlled in the United Kingdom carries on business in a Dominion, the relief from United Kingdom income tax under the Finance Act, 1920, s. 27 (1), in respect of the business is to be determined by ascertaining the assessable income in each country, following the legislative directions in each country as to allowances or deductions and without scrutinising those allowances or deductions by an individual comparison with a different system in the other part of the Commonwealth, and relief should be granted to the extent of the smaller amount. Nothing need be regarded except the two statutory income of the business, taking care to see that

neither includes income from any other source. But when the Dominion law excludes from the assessable income the sum paid in respect of debenture interest, whereas the company has been assessed as agent for its debenture holders in respect of debenture interest paid in the Dominion, as no deduction was permissible in respect of such debenture interest for the purposes of the United Kingdom assessment, it is entitled to relief on the amount so paid, irrespective of how the tax on the interest may ultimately be borne.

(Decision of Finlay, J., reversed).

Cases referred to :

ASSAM RAILWAYS AND TRADING CO. v. INLAND REVENUE COMMISSIONERS [1933] (102 L. J. K. B. 702; (1933) 2 K.B. 576; affirmed in H.L. (1934) 103 L. J. K. B. 583; (1938) A.C. 445).

INLAND REVENUE COMMISSIONERS v. DALGETY & Co. [1930] (99 L.J.K.B. 342; (1930) A.C. 527; 15 Tax Cas. 216)

ROLLS-ROYCE LTD. v. SHORT [1925] (94 L.J.K.B. 849; 10 Tax Cas. 59).

Appeal from the decision of FINLAY, J.

The case stated by the Commissioners for the Special Purposes of the Income tax Acts for the opinion of the King's Bench Division was as follows :

1. At a meeting of the Commissioners for the Special Purposes of the Income tax Acts, held on December 8, 1931, the National Mortgage and Agency Co., of New Zealand, Ltd., hereinafter called "the company" claimed relief in respect of New Zealand Income tax under the provisions of Sec. 27 of the Finance Act, 1920, for the years ended April 5, 1928, and April 5, 1929.

2. The company is a company incorporated in England under the Companies Act with the authorised capital of £ 1,500,000 in 125,000 ordinary shares of 10 each and 25,000 preference shares of £ 10 each. At the material times the issued capital consisted of 125,000 ordinary shares on which £ 2 had been paid up. The company has from time to time issued debentures at varying rates of interest secured upon the uncalled capital of the company. The amount of the debentures outstanding at September 30, 1927, was £ 782,275 9s. 9d.

3. The company, which is controlled in the United Kingdom is a finance company, and its business mainly consists in lending money in New Zealand, on short loans generally secured on crops and on land. By far the greater part of the company's income

arises in New Zealand chiefly from the interest on these loans. The company owns some real property in New Zealand, including premises occupied by it. It also has an investment in New Zealand War Loan and investments in ordinary and preference shares in New Zealand companies.

4. The company is assessed to income tax in the United Kingdom under Case I of Schedule D in respect of all its income from New Zealand, whether arising from the short loans or from the investments which it holds there. In computing the amount of the Case I liability, the debenture interest paid by the company is not allowed as a deduction from the profits, and is consequently included in the assessment to the United Kingdom tax.

5. Income-tax is imposed in New Zealand by the Land and Income tax Act, 1923. The following are the material sections of the Act: (The case then set out Secs. 2, 73, 74, 78, 79, 80, 83, 99, 116, 130, 170 and 171).

6. In computing the assessable income of the company for the New Zealand tax a deduction had been allowed under Sec. 80 (1) (h) for the interest on so much of the debenture capital as had been employed in the production of the assessable income. The amount of interest so deducted was £ 37,861 for the year to September 30, 1926 and £ 34,779 for the year to September 30, 1927 out of the total debenture interest paid by the company of \$ 40,261 and £ 39,822 for those years. There were also deducted under Sec. 83 (1) the sums £ 9,998 and £ 9,999 by way of special exemption, as representing 5 per cent. of the land owned by the company and used by it for the purpose of the business. The dividends from New Zealand companies and the interest on New Zealand War Loan were excluded from the assessable income. The computation for the year 1927-28 resulted in a loss, and no New Zealand income tax was payable for that year. The computation for the year 1928-29 showed an assessable income of £ 26,592, on which the New Zealand income-tax payable was £ 5,982-4s. The computation of the company's profits for assessment to United Kingdom income-tax differed in several other material respects from the computation for the purposes of New Zealand income-tax.

7. The company's investments in New Zealand companies consisted almost entirely of ordinary and preference shares in a company called Levin & Co. Levin & Co., was assessed to New Zealand income-tax and the dividends paid to the company were not again assessed to New Zealand income-tax in the company's

hands. No New Zealand tax was deducted by Levin & Co., from the preference dividends, and the Crown contended that the company had not paid New Zealand tax in respect of these preference dividends. The Crown admitted that the company had paid New Zealand tax on the dividends on the ordinary shares which it held in Lewin & Co.

8. The company was also assessed as agent for its debenture holders for each of the two years in respect of the debenture interest applicable to New Zealand. The tax was in the first place charged on the company at the full rates, but was subsequently reduced to the rates appropriate to the respective debenture holders.

9. The interest on the debentures being payable under a contract made in the United Kingdom, the Company had no power to deduct the New Zealand income tax therefrom, notwithstanding that it had been assessed to that tax for the debenture holders.

10. From computations made it was seen that the items in dispute were: (1) the debenture interest applicable to New Zealand: (2) the allowance of 5 per cent. on the value of the land owned by the company and used by it for the purposes of its business: (3) the dividends on preference shares of Levin and Co. from which no New Zealand tax has been deducted: (4) the New Zealand War Loan interest. The Crown admitted the claim to relief in respect of the dividends on the ordinary shares of Levin & Co.

11. It was contended on behalf of the company: (1) That the relief must be based on the amount of the income as computed for the purpose of the United Kingdom tax, and that the method by which the New Zealand assessment was computed, and the deductions allowed in arriving at that assessment were immaterial. (2) That accordingly the fact that the debenture interest applicable to New Zealand and the allowance of 5 per cent. on the land owned by the company and used in its business were allowed as deductions in computing the New Zealand assessment should not be taken into account, and the relief should be allowed on the United Kingdom figures without any deduction for those two items. (3) That Levin & Co., having paid New Zealand income tax on the profits out of which its preference dividends were paid, the company should be allowed relief on those dividends. (4) Alternatively as regards the debenture interest, the company having paid New Zealand tax thereon, as agent for the debenture holders and having been obliged to bear this tax, was entitled to relief in respect of the tax so paid.

12. It was contended on behalf of the Crown : (1) That no New Zealand tax had been paid by the company for 1927-28 except on the dividends on the ordinary shares which it held in Levin & Co. (2) that the debenture interest and the allowance of 5 per cent on the value of the land had been excluded from the subjects of taxation, in New Zealand, and had not borne tax in New Zealand as part of the Company's profits, and that consequently no relief was due thereon. (3) That on the alternative contention the company was only assessed to tax on the debenture interest as agents for the debenture holders, and this tax was not paid on the company's income.

13. The cases of *Rolls Royce Ltd. v. Short* and *Inland Revenue Commissioners v. Dalgety & Co.*, were referred to.

14. Having considered the facts and arguments the Commissioners gave the following interim decision : The main question in this case is on what part or parts of the income of the appellant company has New Zealand income tax been paid. The appellant company contends that it has paid New Zealand income tax on the whole of its profits arising from its business in New Zealand, while the Crown contends that it has only paid New Zealand income tax on its profits from its business in New Zealand, less the profits applied in payment of its debenture interest for which allowance has been made in calculating its business profits under Sec. 80 (1) (b) of the Land and Income-tax Act, 1928. It was argued on behalf of the appellant company that the whole of the New Zealand income was income from one source, and that in determining the part of the income on which relief is allowable, regard must be had to the source from which it is derived and not to its amount. In support of this argument reliance was placed on a dictum of WARRINGTON, L. J., in the case of *Rolls Royce Ltd. v. Short*. It must, however, be observed, that in that case the Court was only concerned with English income as a whole and Indian income as a whole, and no question arose as to whether Indian income tax had been paid on different parts of the Indian income. It seems clear to us that where under Dominion income tax law different parts of the Dominion income are separately treated as regards the liability to Dominion income tax, we are bound to discriminate between those different parts and see whether Dominion income tax has been paid in respect of each of those parts or not. In this case the income applied in payment of the debenture interest for which allowance has been made has been specifically excluded from the profits on which the

appellant company has been assessed to New Zealand income tax, and consequently no New Zealand income tax has been in fact paid in respect of the profits so applied under the assessments made on the appellant company in respect of its business profits. On the other hand, the appellant company has been separately assessed as agent for its debenture holders in respect of the debenture interest paid by it, and has paid the tax and charged at the rate appropriate to the respective debenture holders' incomes. The appellant company has not been able to reimburse itself by deduction of this tax from its debenture holders. In view of the specific separation of the income applied in payment of the debenture interest for which allowance has been made from the rest of the income, we are of opinion that the income so applied must be regarded as a separate part of the appellant company's income. We hold, therefore, that the appellant company is entitled to relief in respect of the New Zealand income-tax on the profits of its business, less the profits applied in payment of debenture interest of which allowance has been made, but that it is also entitled to relief in respect of the income-tax which it has paid on the debenture interest at the rates appropriate to the respective incomes of the debenture holders such interest being treated as its income under the decision in the case of *Inland Revenue Commissioners v. Dalgety & Co.* There are three subsidiary questions to be dealt with: (a) The income from New Zealand War Loan is specifically exempted from New Zealand income-tax under Sec. 78 (6) of the Land and Income Tax Act, 1923. This is clearly a separate part of the appellant company's income, and as no New Zealand income-tax has been paid in respect of it, the appellant company is not entitled to any relief. (b) 5 per cent. of the capital value of the land used by the appellant company for the purposes of its business or deriving profits therefrom has been allowed as a deduction by way of special exemption in computing the assessable income of the appellant company for the purposes of the New Zealand income-tax. A part of the profits equal to 5 per cent. of the capital value of the land has thus been excluded from the profits in respect of which New Zealand income-tax has been charged, and no New Zealand income-tax has been paid in respect of this part of its profits. We hold, therefore, that no relief is due in respect of this part of its profits. (c) As regards the dividends on the preference shares which the appellant company holds in Levin & Co., although New Zealand income-tax has been paid by Levin & Co., on its profits out of which those dividends have been paid, no New Zealand

income-tax has been paid or suffered by the appellant company on those dividends. On the figures being agreed we will give our final decision ”.

15. The parties having been unable to come to an agreement as to the method of computation of the relief to be allowed in respect of the New Zealand income-tax which the company had paid on the debenture interest, the Commissioners held a further meeting on November 8, 1932, to determine this point.

16. Two questions emerged: (1) As stated in paragraph 8 of this case, the company had paid New Zealand income-tax on the debenture interest at varying rates appropriate to the incomes of the respective debenture holders. Further, certain interest paid to the trustees of the superannuation and provident fund had been altogether exempted from New Zealand income-tax under Sec. 78 (1) of the Land and Income Tax Act of 1923. It was claimed on behalf of the company that the whole of the debenture interest on which New Zealand income-tax had been paid formed one part of the company's income and the relief should be allowed at the rate arrived at by dividing the total amount of the income-tax paid by the total amount of such debenture interest. It was claimed on behalf of the Crown that each item of debenture interest should be taken separately and that relief should be allowed on each item at the rate of income-tax paid on it subject to the restriction imposed by Sec. 27 (1) (b) of the Finance Act, 1920, to one half of the appropriate rate of United Kingdom income-tax. (2) For the year 1927-28 the company had not made enough profit in New Zealand to pay its debenture interest. Accordingly, the debenture interest was paid to the extent of £10,000 out of dividends on United Kingdom investments of the company which were not subject to New Zealand income-tax as income of the company but New Zealand income-tax had been paid by the company on the whole of the debenture interest whether such interest was paid out of New Zealand profits or the United Kingdom dividends. It was claimed on behalf of the company that the sum of £10,000 had borne income both in the United Kingdom and in New Zealand and relief was allowable thereon. It was claimed on behalf of the Crown that the sum of £10,000 was not taxed in New Zealand as income, but was only taxed by reason of its application in payment of debenture interest, and no relief was due thereon.

17. The Commissioners held that the debenture interest as a whole formed part of the company's income and the rate of relief

to be allowed in respect of the tax paid on the debenture interest was to be computed by dividing the total tax paid in respect of the interest by the total amount of the debenture interest including that part which had been exempted from the New Zealand income tax. They further held that the United Kingdom income which had been applied in payment of the debenture interest had suffered both United Kingdom tax and New Zealand income tax and that relief should be allowed thereon accordingly. The amount of relief due was ultimately agreed in accordance with their decisions, and they finally determined the appeal accordingly.

FINLAY, J., upheld the decision of the Special Commissioners save in respect of the debenture interest. He thought that the company paid the tax on that interest only as agents, it could not be said to be paying tax on its own income. The company appealed.

Latter, K.C. and Cyril King for the Appellants.

The Solicitor General (Sir Terence O'Connor, K.C.) and R. P. Hills for the Respondents.

Counsel repeated the arguments indicated in the decision of the Commissioners.

The judgment of LORD WRIGHT, M.R., was read by ROMER, L.J.—I have read the judgments prepared and about to be delivered by my brethren ROMER, L. J., and GREENE, L. J. I am so fully in agreement with these judgments in every respect, both as regards reasoning and conclusions, that it is a work of supererogation to add any observations of my own. But I may perhaps say that as I read the sub-section the protean and ambiguous word "income" as there used means the figure of income or part of income as assessed for tax purposes in either jurisdiction. The income or part of income, that is, the figure so assessed, is that on which the person has paid or become liable to pay tax within the words of the section, in the United Kingdom and in the Dominion respectively. Once it is established, on the principle expounded by my brethren, that the same part of income is assessed in the Dominion as that assessed in the United Kingdom, "double taxation" is *pro tanto* established, on the basis of and to the extent of the smaller assessment: the figures of assessment respectively are the material figures of income for this purpose.

ROMER, L. J.—On this appeal the Court is once more invited to consider and apply the provisions of Sec. 27 (1) of the Finance Act, 1920. As the section has been recently discussed and explained by the House of Lords in the case of *Assam Railways and*

Trading Co. v. Inland Revenue Commissioners, it becomes necessary to examine the facts and the judgments given in some detail.

The facts, so far as material for the present purpose, were as follows: The company concerned was an English company carrying on a business in India, from which business the whole of its income was (with a small exception) derived. It was controlled by its board in England and was accordingly taxed under Case 1 of Schedule D of the Income Tax Act, 1918, on the whole of the profits arising from its business in India. Under the rules applicable to that Case the tax on its income for the year ending April 5, 1929, fell to be computed on the company's profits for its financial year ending on March 31, 1928. The profits so computed amounted to the sum of £ 186,750. Under the Indian Income Tax Act the tax for the year 1928-29 had to be computed on the profit for the same financial year, but those profits when ascertained in accordance with that law amounted only to £ 129,365. This was due to the following facts: (1) According to the Indian Act the sum paid by the company as interest on its debentures and amounting to £42,500 was a permissible deduction, whereas it was not so in the United Kingdom. (2) The profits derived by the company from a certain tea garden amounting to £ 8,343 were excluded from the Indian computation but were included in that of the United Kingdom. (3) other divergencies between the two systems of taxation resulted in a net excess of £ 6,542 in the profits as ascertained in the United Kingdom over the profits as ascertained in India.

The company in due course paid United Kingdom income tax calculated at the appropriate rate on £ 186,750 and paid Indian income tax at the appropriate rate on £ 129,365. In these circumstances it was plain that the company was entitled to relief under Sec. 27 (1). The question to be determined was as to the basis upon which such relief was to be calculated. The contention of the company was this: "The subject of taxation both in India and the United Kingdom is the income derived from the business carried on in India during the year of assessment ending on April 5, 1929. According to the law of each country the tax on that income as ascertained by taking a notional sum that bears no relation to the actual income in fact and applying the appropriate rate to that notional sum. The fact that the notional sums are different in the two countries is immaterial. The notional sums are only brought into notional existence for the purpose of ascertaining what income tax should be charged in the respective countries on

the profits of the business earned in the year of assessment. Having served that purpose they need not be considered further. We have paid income-tax for the year of assessment both in the United Kingdom and in India on precisely the same income and are entitled to relief under the section upon that footing". It is an attractive argument and none the less so because it involves the proposition that throughout the sub-section the word "income" means "income" and nothing else. Had it been accepted, the company would have been entitled to be relieved to the extent of, but not exceeding, half the United Kingdom rate on the sum of £186,750. For the purpose of ascertaining the rate, the actual income from the Indian business would, no doubt, have to be ascertained. But this should present no difficulties to a competent accountant. If any such difficulty should occur it would have to be settled by the appropriate tribunal. The actual profit having been ascertained, the Indian rate and the United Kingdom rate for the purposes of the section would be ascertained by dividing the amount paid in tax in the two countries respectively by the amount of the actual profit.

This contention on the part of the company failed, however, to find acceptance at the hands of the Commissioners for the Special Purposes of the Income-tax Acts, Finlay, J., the Court of Appeal or the House of Lords; and must now be regarded as unsound.

The Special Commissioners held that the company was entitled to relief in respect of the sum of £135,907. This sum was arrived at by deducting from the sum of £186,750 the two sums of £42,500 and £8,343. They treated the sum of £186,750 as being the taxable income in India. They then analysed these two sums and found that, inasmuch as no debenture interest had been deducted in the United Kingdom computation and had been deducted in the Indian computation, £42,500 part of the United Kingdom taxed income had not been taxed in India. They further found that £8,343 had been included in the United Kingdom taxed income but had not been taxed in India. The reason why they did not also find that £6,542, further part of the £186,750, had not been taxed in India would seem to have been that they had not been asked to do so by the Inspector of Taxes. Attention was called to this omission in paragraph 7 of the respondent's case when the matter eventually came before the House of Lords. On an appeal by the company to FINLAY, J., that learned Judge affirmed the decision of the Commissioners and, as I read his judgment,

upon the same grounds as those on which the Commissioner had proceeded.

Pausing there, it is to be observed that the question whether and to what extent income-tax in this country or in India would ultimately fall on the debenture holders in respect of the interest paid to them was immaterial. Income tax on the £ 42,500 had been paid by the company here, and had not been paid by the company in India, and that is all that mattered. For it had been decided by the House of Lords in the *Dalgety Case* that the word "paid" in the section means "paid" and not "ultimately paid".

The decision of FINLAY, J., was affirmed by the Court of Appeal but on somewhat different grounds. They agreed with the learned Judge in treating the sum of £ 186,750 as the income from the Indian business that had been taxed in the United Kingdom, and not merely as a notional sum arrived at for the purpose of calculating the tax to be paid on the real income for the year of assessment. They also treated the £ 129,365 as representing the part of the £ 186,750 that had been taxed in India and as representing, therefore, the only part of company's income from the Indian business that had borne tax in both countries. They made no analysis of the two figures. They rejected, indeed, the idea that any such analysis ought to be made. "When we come to consider," said Lord Hanworth, M. R. (102 L.J.K.B. at p. 706 : (1933) 2 K.B. at p. 593), "what is to be the relief, it has to be shown by the taxpayer that on a part of the income which is his statutory income in the United Kingdom he has paid Dominion income-tax for that year. Now are we to reopen and to readjust the figures in each country? Are we to set aside the items which compose the total assessable income for which the man is to be charged first in the Dominion and afterwards in the United Kingdom? To my mind, not so. You have to deal with the results which have been attained by following the legislative directions in each country, and you have to deal with the result when the exemptions or deductions or abatements have been allowed, and you cannot scrutinise those abatements or deductions by a comparison with a different system in the other part of the Commonwealth and it falls upon the tax payer to prove that he has paid income tax for that year in respect of the same part of his income". The Appeal Court accordingly held that the company was entitled to relief in respect only of £ 129,365. But as the Crown was content with the figure of £ 185,907 arrived at by the Commissioners the appeal was merely dismissed.

The matter was then taken to the House of Lords who unanimously affirmed the decision of the Court of Appeal. Lord Warrington of Clyffe in his speech, summed up the conclusions as follows (103 L.J.K.B. at p. 586; [1935] A.C. at p. 454): "In the present case the part of his income on which the taxpayer has paid tax in England is £ 186,750. In India, he has paid tax on a smaller part numerically of the same income". This was precisely the view of the case that had commended itself to the Court of Appeal. Lord Wright also agreed with that view. "The Court of Appeal" he said (103 L.J.K.B. at p. 587: [1935] A.C. at p. 456), "in confirming (in substance) the ruling of the Special Commissioners took the view (rightly as I think) that the true amount on which relief should be given was £ 129,365". I would call attention to the words "in substance". Later on, he said (103 L.J.K.B. at p. 589; [1935] A.C. at p. 460): On the words of the section it seems that the appellants can only show double taxation in regard to £ 129,365 which is a part of the £ 186,750". LORD BLANESBURGH, LORD ATKIN and LORD THANKERTON agreed with the judgments of LORD WARRINGTON OF CLYFFE and LORD WRIGHT.

The case seems to establish the following conclusions: (1) That the word "income" in the section does not mean the real income, but the "statutory" or "notional income" by means of which the tax is calculated. (2) That if this statutory income in the Dominion is £ A and in the United Kingdom the statutory income from the same source is £ (A plus B) relief will be given in respect of £ A. (3) That an analysis of the two statutory incomes for the purpose of comparing, for example, the respective allowances for repairs or depreciation is inadmissible. It is in regard to the two latter conclusions that the view taken by the Special Commissioners and FINLAY, J., differed from that taken by the higher tribunals. The difference is one of vital importance. If the two statutory incomes are to be dissected, as was done by the Special Commissioners, every item appearing on the debit side in the Dominion account that does not appear on the debit side of the United Kingdom account must be regarded as having borne income-tax in the United Kingdom and not in the Dominion and *vice versa*. If, for instance, in the Dominion £ 1,000 be allowed for depreciation, and nothing for bad debts, and in the United Kingdom £ 1,000 be allowed for bad debts and nothing for depreciation, then although the statutory incomes in the two countries might be equal (say £ 10,000 relief could only be given in respect of £ 9,000. The

same result would occur in case of a difference in relation to receipts of the business. The receipts of the business might in the Dominion be treated as being worth £ 50 less than the value at which the same receipts are brought into account in the United Kingdom. The total statutory incomes might be the same and yet relief would only be given in respect of the statutory income less the £ 50. In cases where the statutory incomes of the two countries are the incomes or average of incomes over different periods of time hopeless confusion would result. In the United Kingdom the statutory income is that of or for the year preceding the year of assessment. In the Dominion it might be that of the year of assessment. In such a case no relief could be granted at all even though the statutory income in the Dominion were equal to that in the United Kingdom. For no item on either side of the two accounts would be the same. The view taken by the Court of Appeal and the House of Lords in the *Assam Case* would, however, lead to no such difficulty. Nothing need be regarded except the two statutory incomes of the business, taking care of course to see that neither includes income from any other source. Relief will then be given to the extent of the smaller of the two sums, without inquiring into the reasons for the difference between them. The statutory income is in such case to be treated as the taxable income for the year of assessment. Both sums must be treated as representing income derived from the same source and for the same period, namely, the year of assessment. It necessarily follows that the smaller sum is a part of the larger sum, as was pointed out both by LORD WARRINGTON OF CLYFFE and LORD WRIGHT in the *Assam Case*.

But just as it is necessary to see that the statutory incomes do not include any receipts from sources other than the business, so also it is necessary to see in each case that no profits of the business are being taxed otherwise than through the medium of the statutory income. For what has to be ascertained for the purpose of the section is how much tax has been paid by the company on its profits in this country and in the Dominions respectively.

It only remains to apply these considerations to the present case, taking for that purpose the year of assessment 1928-29. The United Kingdom statutory income from the whole of the company's business for that year was £ 70,017. This figure, however, included certain receipts from sources other than the business of the company in New Zealand, amounting together to £ 25,549,

leaving the statutory income for the last mentioned business £44,468. The New Zealand statutory income was £26,592. The appellants are therefore entitled to relief in respect of that sum. That would be the only relief to which they are entitled if under the New Zealand law the profits from the New Zealand business are only taxed by reference to the New Zealand statutory income. It appears, however, that the effect of the Land and Income Tax Act 1923, of New Zealand is to exclude from the statutory income a sum equal to the interest on debentures the money secured whereby has been employed in the production of the assessable income, and to tax such sum in the hands of the company. The profits of the New Zealand business are not, therefore, taxed merely by reference to the statutory incomes, but partly by reference to that income and partly by reference to the amount of interest payable in respect of its debentures. The amount taxed under this latter head is the sum of £34,779 and on this sum the company is also entitled to relief. It is true that as regards such last-mentioned part of the company's profits the company has only been assessed as agents for the debenture holders; but this is immaterial. In order to get relief under the section it is sufficient for the company to show that it has paid the New Zealand tax on that part of its profits. The question in what capacity it has paid it and the question whether the tax falls ultimately on the company or the debenture holders are beside the point. The company has paid United Kingdom income tax on a part of its income namely £34,779, and has proved that it has paid Dominion tax in respect of the very same thing. In accordance with the plain words of Sec. 27 (1) of the Finance Act 1920, it is entitled to relief on that sum.

For these reasons I am of opinion that both appeals should be allowed.

GREENE, L.J.—Sec. 27 (1) of the Finance Act 1920, provides as follows: "If any person who has paid, by deduction or otherwise, or is liable to pay, United Kingdom income tax for any year of assessment on any part of his income proves to the satisfaction of the Special Commissioners that he has paid Dominion income tax for that year in respect of the same part of his income, he shall be entitled to relief from United Kingdom income tax paid or payable by him on that part of his income at a rate thereon to be determined", as therein mentioned. The language of this provision appears at first sight to be reasonably clear. The first thing to consider is whether the person claiming relief is liable

to United Kingdom income tax "on any part of his income". His income for the purposes of the United Kingdom income tax may comprise a number of elements derived from different sources and taxable under different schedules. Any one of these elements may be a "part of his income" for the purposes of this limb of the sub-section. The next question for consideration is whether he has paid Dominion income tax for the year in question "in respect of the same part of his income". It is said that in strictness the word "same" is necessarily inappropriate to convey the meaning intended, since income as assessed for United Kingdom income tax is a notional sum and the income on which Dominion income tax is paid cannot be the "same". This, to my mind, presents no practical difficulty in construing the sub-section, nor am I prepared to find in its language such abstruse metaphysical difficulties as were suggested in the arguments for the Crown. The sub-section says that identity exists and as a practical matter I can find no difficulty in treating the assessed income which is taxed in a Dominion as being the "same" as that taxed in the United Kingdom. Now even if the matter had been devoid of authority, I should have thought that the character of the identity postulated by the words "the same part of his income" was not difficult of ascertainment. If the income is derived from dividends on shares or interest on debentures, and it is taxed in both countries the identity is apparent. If the income is derived from a business, the question is more complicated but, not in my opinion, any more difficult to answer. In such a case, in order to ensure the identity which the sub-section requires, the first thing to do is to see that the income taxed in the Dominion is the same as that taxed in the United Kingdom in the sense that each includes, and includes only, income (that is to say incoming profits or gains) which is common to both and any necessary adjustments of the account to ensure this result must be made. To take a single example: if an English company carries on from England business both in England and in a Dominion, its assessment here will be on the amount of the profits of the entire business. But in the Dominion it will be assessed only on the profits of the business so far as carried on in the Dominion. It is accordingly necessary in order to achieve the primary identity of the two incomes, to dissect the United Kingdom assessment and eliminate from it that portion which represents the profits of the English business. This is a perfectly simple and intelligible operation, and presents no difficulty in principle. But it will be noticed that the only matters to be

eliminated from the United Kingdom or the Dominion assessment (as the case may be) are incoming profits or gains which are not common to both assessments. It is, in my judgment, essential to the proper understanding of this case, to appreciate the fundamental distinction between sums which truly represent incoming profits and gains and sums which represent allowances or permissible deductions in arriving at the assessable income. For reasons which will appear later, it is only the former, which must be eliminated, not the latter. But the process of arriving at the identity of the two incomes does not stop at the point where incoming profits or gains not common to both assessments have been eliminated. When this has been done, the resultant figures for the United Kingdom income and the Dominion income will in all probability be different by reason of differences in the two methods of arriving at assessable income. It must have been present to the mind of the Legislature that uniformity in the method of assessing business profits is not to be found throughout the Empire. The rules for the deduction or non-deduction of expenses or the allowance for wear and tear (to take some examples) which operate in the United Kingdom, may differ widely from those in force in a Dominion. And here it is necessary to see that what I may call a secondary identity is attained. If after the elimination of incoming profits or gains which are not common to both assessments the income from the Dominion business is for the purpose of the United Kingdom assessment (let me say) £10,000 and for the purpose of the Dominion assessment £8,000 it is only in respect of £8,000 that the identity exists. £8,000 is not "the same part" of the company's income as £10,000 even though each figure represents an assessment in respect of the same incoming profits or gains. The relief given by the sub-section is therefore to be ascertained on the footing that the only part of the business income in respect of which tax is exigible in both countries is £8,000. In the converse case if the figures are reversed the only part of the company's income on which tax is exigible in the United Kingdom will be £8,000 and the additional £2,000 in the Dominion assessment will not entitle the company to any relief.

In support of the views expressed above, I may quote some words from the speech of the present Master of the Rolls in the *Assam Case* (103 L.J.K.B. at p. 589; (1935) A.C. at p. 459). His Lordship said: 'It seems clear that there must be a definite part of income brought into question, and that can only be expressed in a sum of money. As income *ex vi termini* must be expressed in

a sum of money, the words 'the same part of his income' must involve a comparison between two sums of money, which prove to be the same. The contention of the appellants is to the contrary: it is said on their behalf that the words 'the same part of his income' refer solely to what is called the source and that identity of amount is immaterial and does not come into question, except for the purpose of ascertaining the rate of tax to be allowed for. I cannot agree with this argument. No doubt questions of source, as it has been called, that is, such questions as where the income comes from, are essential to identify, so far as that aspect goes, what is taxed in the United Kingdom with what is taxed in the Dominion: but in addition the income itself, that is, the amount of money, must also be identified. I think the words 'the same part of his income' are apt to include both elements of comparison and identification". LORD BLANESBURGH (103 L.J.K.B. at p. 585; (1935 A.C. at p. 452) expresses the same view in a different way.

In order to apply these principles to the present case, it is necessary to examine shortly the facts relating to the two assessments. There are some variations in the figures in the various documents due to certain adjustments which have been made, but I will take the round sums which will readily be recognisable. The figure of the United Kingdom assessment for the year 1928 29 is £70,000. This includes, in addition to the profits of the business in New Zealand, the following items of incoming profits or gains: 1. United Kingdom profits: 2. New Zealand War Loan interest: 3. New Zealand Preference Dividend: 4. Ordinary dividends on shares in "X", amounting in round figures to £25,000.

Now none of these items is brought into the New Zealand assessment and the first step necessary to secure identity between the two incomes is to deduct them from the United Kingdom assessment which will then give the figure of £45,000 as representing that part of the United Kingdom assessment which is exclusively referable to that part of the income which is taxed in both countries. This is what the Master of the Rolls in the *Assam Case* describes as "identification of what is taxed in the United Kingdom with what is taxed in the Dominion". Now the New Zealand assessment in respect of that part of the income is £26,000 only, and it is in respect of this figure that what the Master of the Rolls describes as "identification of the income itself, that is, the amount of money" exists. The result, in my opinion, is that the appellants are entitled to relief upon the basis that to the extent of the assessment of £26,000 they have paid

Dominion tax upon the profits of the New Zealand business which are the same subject-matter of taxation as those covered by the United Kingdom assessment as adjusted in the way which I have described. This result appears to me to accord with the language of the sub-section, the construction placed upon it by the House of Lords in the *Assam Case*, and with good sense.

Upon the view of the meaning of the sub-section which I have expressed, differences between the rules prevailing in the two countries as to such matters as allowances and deductions of expenses are entirely disregarded. To take a simple example let me assume that the method of arriving at the assessable profits as a Dominion business is identical both in principle and in the matter of amount in both countries with the exception of wear and tear allowance, and gives for each country a figure of £10,000 before deducting that allowance. Let me assume then that the allowance in the United Kingdom is £750 (giving a United Kingdom assessment of £9,250) and in the Dominion £1,000 (giving a Dominion assessment of £9,000). The business income on which Dominion tax has been paid will be £9,000, that on which United Kingdom tax has been paid will be £9,250 and relief will be given accordingly. It is quite illegitimate, in my opinion, to treat the difference between the two allowances, namely, £250 as in some sense a part of the business income which has not suffered tax in the Dominion and as therefore, for the purpose of the sub-section to be deducted from the United Kingdom assessment under the guise of eliminating from that assessment a piece of income which has not borne tax in the Dominion. In truth, what has borne tax in the Dominion in such a case, is the business profits as assessed, not merely a part of those profits ascertained after deducting the excess of the Dominion allowance over the United Kingdom allowance. Nor is the position, in my opinion, any different if one of the countries makes an allowance or permits a deduction of a kind not recognised in the other country. Again, let me take a simple example. I will assume that all figures are identical in the two countries except that in the United Kingdom an allowance is given which is not given in the Dominion—for example an allowance of £500 in respect of bad debts, giving an assessment of £9,500 and a deduction is permitted in the Dominion which is not permitted in the United Kingdom—for example an allowance of £500 in respect of certain expenses of the business, giving an assessment of £9,500. The two figures which are comparable for the purposes of relief under the sub-section will be £9,500 and £9,500—not

£ 9,000 and £ 9,000 as they would have to be if the £ 500 in each case were to be treated as an untaxed part of the business profits.

It is at this point that what, in my opinion, is the fallacy underlying the Crown's argument on this part of the case emerges. It is due to a failure to distinguish between two things fundamentally different, namely, an incoming profits and an allowance or deduction. I have already referred to the items of incoming profit which are included in the United Kingdom assessment but not in the New Zealand assessment and shown how these must be deducted from the United Kingdom assessment for the reason that that assessment is *pro tanto* referable to these items. But the Crown seeks to treat on the same basis as these items certain sums representing allowances or deductions made in New Zealand, namely, (1) debenture interest (2) 5 per cent unimproved value of land allowance, amounting in round figures to £45,000. These sums it is said must be deducted from the United Kingdom assessment on the basis that they are pieces of income, not taxed in New Zealand, to which *pro tanto* the United Kingdom assessment is referable. The result is to reduce the United Kingdom assessment to nothing or a minus quantity for the purpose of the sub-section and to destroy the claim to relief. But it is to be noticed that the effect of these allowances and deductions is in itself to reduce the amount of the New Zealand assessment and so to reduce the area of double taxation in respect of which the relief may be claimed. To use them again for the purpose of still further reducing that area is in my opinion wholly illegitimate.

The Crown's argument here is, in my judgment based on a misconception of the effect of the *Assam* decision. I have had the advantage of reading the analysis of that decision contained in the judgment which my brother Romer has just read and I entirely agree with it. I only wish to add one observation of my own. In the *Assam Case* the appellants were endeavouring to write back into the Indian assessment two sums which had not entered into that assessment at all, one of which was an item of incoming profit not taxed in India, namely, the Bogapani Tea Garden account, and the other of which was a deduction in respect of debenture interest. For the purpose of the decision in that case the difference in character of these two items was irrelevant; it was equally inadmissible to add back the one and the other in order to *write up the Indian assessment above its true figure*. But this is an entirely different thing to saying that the fact that a particular deduction is allowed in a Dominion which is not allowed in the

United Kingdom can be used in order to *write down the United Kingdom assessment below its true figure* which is what the Crown claims to be able to do in this case.

I have so far dealt only with the New Zealand assessment in respect of business profits and for that purpose I have treated the deduction of a sum equal to the debenture interest as to what for the purpose of that assessment it in fact is, namely, a true deduction of a business expense. But the company was assessable and was in fact assessed in respect of what it paid for this interest under a different provision of the New Zealand Statute, namely, Sec. 116. Under that section a company is to be the agent of the debenture holders for the purposes of the Act and is assessable in respect of interest paid to them accordingly. The appellants contend that as no deduction was permissible in respect of the debenture interest for the purposes of the United Kingdom assessment they have paid United Kingdom income tax upon it; that they have also paid New Zealand income tax upon it; that the fact that under the New Zealand Act this tax is chargeable under a different section is irrelevant since all that Section 27 (1) of the Finance Act 1920, requires is that Dominion tax shall have been paid: and that the fact that under the New Zealand statute they are to be deemed to have paid as agents and have in New Zealand a statutory right of recovery against the debenture holders—a right which is not enforceable in this country—is also irrelevant. In my opinion the argument of the appellants upon this point is right. Whether or not the part of the company's income in respect of which it has paid tax in the Dominion is the same as the part of its income on which it is chargeable to United Kingdom income tax is in my judgment to be decided by reference to English law alone: and the fact that for purposes of its own the New Zealand Legislature has chosen to treat the sum paid away in interest as in a different tax category to that in which it is treated here cannot in my opinion affect the matter. I agree that the appeal should be allowed.

Appeal allowed.

[IN THE PATNA HIGH COURT].

SONU LAL

v.

COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA.

SIR COURTNEY-TERRELL, C. J., and AGARWALA, J.

November 15, 1937

HINDU UNDIVIDED FAMILY—BUSINESS CARRIED ON IN DECEASED MEMBERS' NAME—NOTICE ISSUED IN THAT NAME AND SERVED ON MANAGER FOR TIME BEING—VALIDITY—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 63.

The assessee, a Hindu undivided family, carried on business in the name and style of 'Gajo Ram Basant Ram'. As the business was continued in the same name even after the death of Gajo Ram and Basant Ram, notices under the Income Tax Act were issued in the name of Gajo Ram Basant Ram and they were served on the karta of the family, who appeared in the proceedings and filed a return. After the assessment he appealed on the ground that the demand notices were illegal as they were issued in the names of Gajo Ram and Basant Ram who were dead : Held, that, as the family in its trading capacity was known as Gajo Ram Basant Ram, and the notices were served on the karta, there was no defect in procedure either in substance or in form and the assessment could not be impeached on this ground.

Raj Kishore Prasad, for the Assessee.

Sen Gupta, for the Commissioner of Income Tax.

AGARWALLA, J.—The Commissioner of Income Tax was called upon by this Court to state a case on the following question : "Whether the assessment made in this case in the names of Gajo Ram and Basant Ram, who are dead, is valid ?" The findings of fact of the Commissioner are that the assessee, a Hindu undivided family, carry on a family business under the name and style of Gajo Ram Basant Ram. Gajo Ram and Basant Ram have been dead for some years but the business is and always has been carried on in their names. The notices required under the Act were issued in the trading name of the family, i.e., Gajo Ram Basant Ram, and were served on the *karta* of the family. They were accepted by him and he appeared in the proceedings before the Income-tax Officer and filed a return. After the assessment had

been made he appealed to the Assistant Commissioner objecting to the assessment on the ground that the demand notices had been served in the names of Gajo Ram Basant Ram who were dead and challenged the assessment on that ground. Learned Counsel for the assessee in this Court referred to Sec. 63 of the Income Tax Act, which provides that notices under the Act may be served on the person named therein either by post or as if it were a summons issued by a Court and, in the case of a Hindu undivided family, may be addressed to any adult member of the family. It is contended that the notices were not addressed to an adult member of the family but to two dead members of the family. The argument is fallacious. The family, in its trading capacity, is known as Gajo Ram Basant Ram and the notices were addressed to the family in the name by which it has chosen to be known. It would have been a sufficient compliance with the requirements of the section to address them to an adult member of the family but they were in fact addressed to the family itself, they were accepted as notices to the family and the *karta* on behalf of the family filed a return of the family's income. There has been no defect in procedure either in substance or in form.

I would, therefore, answer the question submitted to us in the affirmative. The Commissioner of Income-tax is entitled to his costs: hearing fee Rs. 100.

COURTNEY TERRELL, C. J.—I agree.

[IN THE HIGH COURT OF RANGOON].

BANSIDHAR & SONS

v.

COMMISSIONER OF INCOME TAX, BURMA.

SIR E. H. GOODMAN ROBERTS, C. J., and DUNKLEY, J.

November 10, 1937.

HINDU UNDIVIDED FAMILY—FORMATION OF PARTNERSHIP FOR CARRYING ON BUSINESS OF FAMILY WITHOUT PARTITION OF FAMILY—APPLICATION FOR REGISTRATION OF FIRM—MAINTAINABILITY—INDIAN INCOME TAX ACT (XI OF 1922), Secs. 25-A, 26-A.

Before persons who have been previously assessed as a Hindu undivided family can claim to be separately assessed as members of

a contractual partnership they must establish that the joint family has been dissolved. Where the members who apply for registration as a firm admit that for all purposes other than the business in question they continue to be a joint family, evidence to show that there was no ancestral property and the business was originally built up by the father with his own self-acquired property is irrelevant.

Where the members of a Hindu undivided family who were being assessed as a family claim that they have formed themselves into a contractual partnership in respect of their business, their application is governed not by Sec. 26-A, but by Sec. 25-A.

Under Sec. 25-A, the Income Tax Officer has a discretion to conduct an inquiry in such manner as may seem to him in his judgment to be best in the circumstances of the case and to hear such evidence, and such evidence only, as he may consider necessary, and his decision therein is a decision on a question of fact which cannot be canvassed before the High Court under Sec. 66.

Application under Sec. 66 (3) of the Indian Income-tax Act.
D. J. Daniel for the Applicant.

Advocate-General for the Respondent.

JUDGMENT.

DUNKLEY, J.—This is an application under Sec. 66 (3) of the Indian Income-tax Act by one Bansidhar and his five sons, who admittedly form a Hindu joint family but it is now alleged that the business in respect of which they have been assessed to income-tax is not joint family property. From the year 1932-33 they were annually assessed to income-tax under Sec. 3 of the Act as a Hindu undivided family in respect of the profits of this business, but when the time came for the assessment for the year 1936-37 a claim was made that Bansidhar and his five sons formed a contractual partnership in respect of and for the purpose of carrying on this business, and not a Hindu undivided family. The deed of partnership between them was ultimately produced, although there was considerable delay in its production and an application purporting to be under Sec. 26-A of the Act was made for the registration of this partnership for the purposes of the Income-tax Act. The Income-tax Officer held an enquiry and came to the conclusion that the family still remained undivided and refused to register the partnership. His decision on this point was upheld on appeal by the Assistant Commissioner of Income-tax, and further on revision of the latter's order, by the Commissioner of Income-tax. It is out of the final order of the Commissioner that the present application has arisen.

Now, the question of law on which by their application the applicants desire us to require the Commissioner of Income Tax to state a case is propounded in paragraph 13 of the present application as follows :—

“Is it legal in the circumstances of this case to hold that there is no partnership between Bansidhar and his five sons or, in other words, is it legal for the head of a Hindu joint family who has no ancestral property to enter into a partnership with his sons in respect of his own self-acquired or separate business, which was built up by him individually without the employment of any ancestral funds, even though he and his sons live together as a Hindu undivided family ? ”

But in the course of the argument it has been admitted by learned counsel for the applicants that this question does not cover the real grievance of the applicants and does not arise out of the order of the Commissioner of Income Tax. The real grievance of the applicants is entirely different and has arisen under these circumstances.

By an order dated 11th January 1937, the Commissioner directed the Income Tax Officer, Magwe, to record any evidence called by the applicants to establish that this business was not created out of ancestral property ; this evidence was to be heard at Tungwingyi, where the business is carried on. Subsequently, on the 16th March, on the representation of the applicants that several of the witnesses whom they desired to call resided in Rangoon, the Commissioner directed the Income Tax Officer to cause these Rangoon witnesses to be examined on commission. For some reason this was not done, and the proceedings were returned to the Commissioner without these Rangoon witnesses having been examined. The Commissioner before passing orders failed to examine these Rangoon witnesses. He declined to hear them on the ground that the applicants desired to adduce this evidence to show that the business was started without capital and was built up by the sole efforts of the head of the family, and even if these facts were established they would not assist the applicants in proving that they do not constitute a Hindu undivided family within the meaning of that term as used in the Income Tax Act. The grievance of the applicants is the refusal of the Commissioner to examine these witnesses. Their learned Counsel now admits that the question which he desires to have referred ought to be framed in some such form as the following : “ Whether the order of the Commissioner of the 23rd April 1937, is good in law in view of his refusal

to examine all the witnesses tendered for the purpose of proving the alleged partnership".;

Now, in the case of *Kalyanji Vithaldas v. The Commissioner of Income Tax, Bengal* (1937 I.L.R. Calcutta p. 653) their Lordships of the Privy Council have pointed out that the term "Hindu undivided family" as used in the Income Tax Act has a wider significance than the Hindu joint family known to Hindu law ; and in *In re Bisweswarlal Brijlal* (I.L.R. LVII Calcutta p. 1336) RANKIN, C.J., pointed out that before persons who have been previously assessed as a Hindu undivided family can claim to be separately assessed as members of a contractual partnership they must establish that the joint family has been dissolved. In view of the admission of the applicants that for all purposes other than this business they continue to be a joint family, evidence regarding the origin and growth of this business would plainly be useless in this case.

Apart from this consideration, this application fails on another ground. The application to the Income Tax Officer for registration of the firm has been treated throughout, by the Income-tax Officer, by the Assistant Commissioner and by the Commissioner of Income Tax, as an application under the provisions of Sec. 26-A of the Act although it did not comply with the provisions of this section and the rules made thereunder. Clearly this application lay, not under the provisions of Sec. 26-A, but under the provisions of Sec. 25-A which has reference to a claim made by or on behalf of a Hindu family which has hitherto been assessed as undivided, that partition has taken place among the members of the family. The provisions of this section were plainly applicable to the original claim made by the applicants.

Now, under Sec. 25-A, when such a claim is made the Income Tax Officer shall make such inquiry thereinto *as he may think fit*, that is, he has a discretion to conduct that inquiry in such manner as may see to him, in his judgment, to be best in the circumstances of the particular case and to hear such evidence, and such evidence only, as he may in his discretion consider it necessary to hear to enable him to come to a decision on the question whether a separation of the members of the family has taken place or not. His decision is a decision on a question of pure fact, and so long as his discretion is not exercised arbitrarily or fancifully, and there are before him some materials on which he can arrive at the conclusion at which he has arrived, his decision cannot be canvassed before the High Court on an application under Sec. 66, because

no question of law can arise thereout. There is in the present case, in the admissions of the applicants alone, ample material on which the Income-tax Officer, and subsequently the Assistant Commissioner and Commissioner of Income-tax, could arrive at the decision at which they did arrive and the applicants cannot be heard under the provisions of Sec. 66 to complain that in the exercise of his discretion the Commissioner of Income-tax declined to hear certain evidence.

This application therefore fails and is dismissed with costs 10 Gold Mohurs.

E. H. GOODMAN ROBERTS, C.J.—I agree.

[IN THE ALLAHABAD HIGH COURT].

S. C. MULLICK & SONS, *In re*.

NIAMATULLAH, Acting C. J., and MOHAMMAD ISMAIL, J.

October 25, 1937.

HINDU UNDIVIDED FAMILY—FORMATION OF FIRM TO CARRY ON FAMILY BUSINESS—NO EVIDENCE TO PROVE PARTITION OF FAMILY—APPLICATION FOR REGISTRATION OF FIRM—MAINTAINABILITY—MERE EXECUTION OF PARTNERSHIP DEED, EFFECT OF—DAYABHAGA FAMILY—PARTITION—DIVISION BY METES AND BOUNDS, WHETHER NECESSARY—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 25-A, 26-A.

Persons cannot at one and the same time be members of a joint Hindu family in respect of a joint family property and be also members of a firm of which such property forms the assets; and the mere fact that a partnership deed has been executed in respect of the business of the family is not by itself sufficient to show that there has been a division of the family.

The assessee who carried on a business were assessed on their income including the income from this business as a Hindu undivided family up to the year 1934. In that year a deed of partnership was executed by the assessee in which it was alleged that the assessee had all along been carrying on the business in partnership and that the firm was re-constituted in 1938 and an application was made for registration of the firm: Held, that the assessee being

members of a Hindu family and descendants of the same common ancestor should be presumed to be joint until the contrary was established; apart from the possible inferences in the partnership deed, which were not binding on the Income Tax Department, there was no evidence to rebut the above presumption; the deed of partnership cannot be considered to have brought into existence a legally constituted firm, as persons cannot at one and the same time be members of a joint Hindu family in respect of a joint family property and be also members of a firm of which such property forms the assets and the assesseees could therefore be rightly assessed still as a joint Hindu family.

Though the recitals in a partnership deed may be evidence and even conclusive evidence as between the parties to it, the income tax department is not bound to accept them as correct and can call upon the executants thereof to prove the facts recited therein.

Obiter: Partition by metes and bounds is not necessary for the division of a Dayabhaga family, but an unequivocal declaration of intention to separate must in any case be proved.

GANGA SAGAR ANANDA MOHAN SAHA [1930] (33 C. W. N. 1190; A.I.R. 1930 Cal. 178.) referred to.

Case stated under Sec. 66 (2) of the Income Tax Act.

STATEMENT OF CASE.

Case stated by the Commissioner of Income Tax, Central and United Provinces, under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922 (hereinafter referred to as the Act) at the instance of Messrs. S. C. Mullick and Sons, Benares, Hindu undivided family within the meaning of Sec. 3 of the Act (hereinafter referred to as the assessee), for the decision, by the Hon'ble the High Court of Judicature at Allahabad, of the following questions of law arising out of the Assistant Commissioner's order under Sec. 31 in respect of the assessee's assessment to income tax for the year of assessment, 1934-35 (hereinafter referred to as the year in dispute):

(1) "Whether the order of Additional Income Tax Officer holding that the petitioners *ab initio* constituted an undivided Hindu family, though governed by the Dayabhag branch of Hindu Law, is illegal as it is based on no admissible evidence on the records of the case in rebuttal of the sworn statements of the partners".

(2) "Whether the application for registration, dated the 23rd July 1934, accompanied with the partnership deed dated the

14th July, 1934, specifying the individual shares of partners and subsequently proved by the sworn statement of partners and the production of the certificate of registration of the firm by the Registrar of Firms, United Provinces, dated the 30th July, 1934, fulfilled the requirements of Sec. 26-A of the Indian Income Tax Act, 1932, and the registration ought to have been effected by the Income Tax Officer ”.

(3) “ Whether a family governed by the Dayabhag branch of Hindu Law in which shares of all the members never remain unascertained, is an undivided Hindu family contemplated by the Indian Income Tax Act, 1922, taking into consideration the features of Mitakshara branch Hindu Law under which the partition of an undivided Hindu family takes effect immediately by intention to separate and ascertainment of shares though the property may never be divided by metes and bounds ”.

2. The relevant facts of the case are as follows :

In the year 1905 one S. C. Mullick settled down in Benares with his two sons (1) A. D. Mullick and (2) K. D. Mullick, the latter a minor. On his arrival in Benares he started a hardware business which proved prosperous. In the year 1930 Mr. Mullick the founder of the business, died, leaving his two sons and grandsons with considerable property and the business. One of the two sons A. D. Mullick died in June 1933, leaving seven sons two of whom are of age and the remaining five minors. The other son K. D. Mullick has two sons. The family now consists of Mr. K. D. Mullick, his two sons, and the seven sons of his brother late A. D. Mullick. They are governed by the Dayabhag School of Hindu Law. According to this school of Hindu Law the shares of the coparceners are defined. The seven sons of Mr. A. D. Mullick are alleged to be the owners of one half or one fourth share each and Mr. K. D. Mullick with his two sons is alleged to be the owner of the remaining half or a one sixth share each in the property and the business. All the coparceners admittedly live and mess jointly and they have hitherto been assessed as a Hindu undivided family. Upon the service of a notice (in the ordinary course) under Sec. 22 (2) for the submission of a return of income for the year in dispute Mr. K. D. Mullick on the 23rd July, 1934, submitted an application for registration under Sec. 26-A, accompanied by a deed of partnership dated the 14th July 1934. As the question of a disruption in the family was implicit in this application, the Income-tax Officer, Benares, served on all the members of the family notices under Sec. 25-A (1). In response

to these notices they filed written statements alleging (1) that they did not constitute a Hindu undivided family because they were governed by the Dayabhag school and (2) that a partnership had existed since the very outset when Mr. S. C. Mullick founded the business. Both the contentions were repelled by the Income Tax Officer who accordingly came to the conclusion that there was no disruption in the Hindu undivided family and that the members continued to constitute one. Such a conclusion was fatal to the emergence of a firm from it. In the result the Income Tax Officer, therefore, declined to register them as a firm and rejected the application for registration under Sec. 26-A. The assessee appealed but was unsuccessful, the Assistant Commissioner confirming the order of the Income Tax Officer. A copy of the appellate order under Sec. 31 is in Appendix C (Not printed). The assessee now demands a reference under Sec. 66 (2) of the three questions of law set out above.

Questions for the decision of the Hon'ble High Court:

The questions as stated by the assessee incorporate argument and are also not put in logical order. I therefore restate them in the following form:

(1) "Whether the assessee, being a family governed by the Dayabhag branch of Hindu law, is a Hindu undivided family within the meaning the Indian Income Tax Act, 1922";

(2) "If the answer to the first question is in the affirmative whether there was evidence upon which the Additional Income Tax Officer could hold that no partition had taken place among the members of the family";

(3) "Whether in the circumstances of this case, the Income Tax Officer was justified in going behind the partnership deed, dated the 14th July, 1934, and holding that there was no firm in existence such as could be registered under Sec. 26-A of the Indian Income Tax Act, 1922".

4. Opinion of the Commissioner—Question (1)—In the case of *Gangasagar Anand Mohan Saha* (4 I.T.C. 55) their Lordships of the Calcutta High Court were pleased to observe as follows—
 "Now every Hindu family is presumed to be joint in food, worship and estate. Under the Dayabhag Law each coparcener takes a defined share. The essence of a coparcenery under the Mitakshara Law is unity in ownership, whereas under the Dayabhag Law the essence of a coparcenery is unity in possession. So long as there is unity of possession, no coparcener can say that particular share of the property belongs to him. That he can say only

after a partition. Partition, then according to the Dayabhag law, consists in splitting up joint possession and assigning specific portions of the property to the several coparceners ”.

It is clear from the above observations that the conception of a coparcenary body, joint and undivided in possession, is common to both the schools of Hindu Law and there is nothing in the Act to warrant the assumption that a Hindu undivided family governed by the Dayabhag School was outside the purview of Sec. 25-A or any other section thereof where reference is to such a family. I, therefore, submit respectfully that this question should be answered in the affirmative.

Question (2)—The assessee's contention appears to be that as against the recital in the partnership deed of July 1934, and the statements of the so-called partners the Income tax Officer had no admissible evidence on the basis of which he could hold that the assessee was a Hindu undivided family since the very commencement of the business in the year 1905. Apart from the reasons given by the Assistant Commissioner there is the outstanding fact that the assessee has been assessed as a Hindu undivided family at least since the year 1926-27 and the evidence of previous records was available to the Income tax Officer as a piece of relevant evidence for the decision of the question. There was, therefore, ample evidence for the Income tax Officer's finding.

Question (3)—Sec. 26 has reference to a firm and the essential condition for the making of an application under it is that such an application should be made on behalf of a firm—a legally constituted firm—and not on behalf of what has been found not to be a firm but a Hindu undivided family. Where a given body of individuals is found not to be a firm the mere fact that the formalities of constituting it into a firm have been gone through does not satisfy the requirements of this section. For these reasons, it cannot seriously be contended that the question arises unless the answer either to question (1) or to question (2) is in the negative. If the answer to either question is in the negative, then, in my humble submission, the result will be that the case will have to be referred back so that the Income tax Officer may deal with the application under Sec. 26-A in the light of such answer.

5. As required by rule 7 of the Rules framed by the High Court, a relevant portion of the statement of the case was sent to the assessee for observations and suggestions, if any, within 14 days from the date of its receipt. The cover was delivered to the assessee on the 29th June, 1936. He should, therefore, have

submitted his reply by the 13th July 1936. A reply was however, received in this office on the 15th July, 1936, i.e., 2 days after the time allowed. The alterations and additions suggested by him seem to me irrelevant and I decline to make them."

JUDGMENT.

MOHAMMAD ISMAIL, J.—This is a reference by the Income Tax Commissioner under Sec. 66 of the Income Tax Act. Before we state the questions which we have to answer it is necessary to state such facts as will indicate the implications of those questions.

At page 9 of the statement of the case will be found a pedigree. The common ancestor is one Lakhi Narain Mullick. One of his sons, S. C. Mullick, migrated from Bengal to Benares and there started hardware business, which proved to be lucrative and became the foundation of the fortune of the family. S. C. Mullick had two sons, A. D. Mullick and K. D. Mullick. S. C. Mullick died in 1930. His elder son A. D. Mullick died in 1933. K. D. Mullick who is alive has two sons and A. D. Mullick has left 7 sons. Up to 1934 the entire family was treated for income tax purposes as a joint Hindu family governed by the Dayabhag School of law and assessed as such. On the 14th July, 1934, a deed, purporting to be one of partnership was executed by K. D. Mullick, his two sons, and the seven sons of A. D. Mullick. The deed recites that when S. C. Mullick settled down in Benares with his two sons, one of whom, namely, K. D. Mullick, was a minor at the time, they started business as partners and that subsequently the sons of the two brothers were admitted into partnership and constituted a firm. The deed goes on to recite that the firm was "reconstituted" after the death of A. D. Mullick in 1933. Finally, the deed declares that the entire stock-in-trade of the hardware business belongs to a firm of which the executants thereof are partners. On 23rd July, 1934, K. D. Mullick applied under Sec. 26-A of the Income Tax Act for registration of the firm. With the application the deed of partnership, already referred to, was filed. Though, to begin with, the controversy was in connection with the application for registration, assessment proceedings appear also to have been taken and the question arose whether the income of the hardware concern should be considered to be the income of a firm of which S. C. Mullick's descendants are partners, or the income of a joint Hindu family consisting of K. D. Mullick and the sons of A. D. Mullick. It was contended by the assesseees that they were members of a firm; while the Income Tax Department treated the income as that of a joint family governed by the

Dayabhag school of law. The Assistant Commissioner held that A.D. Mullick and K.D. Mullick, and after the death of A.D. Mullick, his 7 sons and K.D. Mullick were members of a joint Hindu family governed by the Dayabhag law and the assets of the hardware business were joint Hindu family property. He also held that the deed of partnership, dated 14th July 1934, represented a fictitious transaction. The Assistant Commissioner expressed the view that members of a joint Hindu family cannot become partners *qua* joint family property. The application for registration under Sec. 26-A was rejected. The reference before us was made by the Commissioner of Income-tax at the instance of K.D. Mullick. The three questions which we are required to answer are as follows:—

“(1) Whether assessee, being a family governed by the Dayabhag branch of Hindu Law, is a Hindu undivided family within the meaning of the Indian Income-tax Act, 1922 ;

(2) If the answer to the first question is in the affirmative, whether there was evidence upon which the Additional Income Tax Officer could hold that no partition had taken place among the members of the family ; and

(3) Whether in the circumstances of this case, the Income-tax Officer was justified in going behind the partnership deed, dated the 14th July 1934, and holding that there was no firm in existence such as could be registered under Sec. 26-A of the Indian Income-tax Act, 1922 ”.

As regards the first question, the Commissioner has expressed the opinion that members of a Dayabhag family cannot become separated members thereof, except by a division of its property by metes and bounds. He has referred to *Ganga Sagar Ananda Mohan Saha* which was a converse case. The assesseees in that case claimed to be members of a joint Hindu family governed by the Dayabhag Law, while the Income-tax Department maintained the contrary. C. C. GHOSH, J., who delivered the judgment of the Full Bench, observed that “The essence of a co-parcenary under the Mitakshara Law is unity of ownership whereas under the Dayabhag Law the essence of a coparcenary is unity of possession. So long as there is unity of possession no coparcener can say that a particular share of the property belongs to him. That he can say only after a partition. Partition then, according to the Dayabhag Law consists in splitting up joint possession and assigning specific portions of the property to the several coparceners ”. The question in that case was whether certain circumstances furnished

evidence of partition in a Dayabhag family and what seems to have been emphasised is that partition could not be held to be established only because the members were separate in mess and residence and held the family property in defined shares. We do not think that that case is an authority for the proposition that it is not open to the members of a Dayabhag family to become divided members, except by dividing the family property by metes and bounds, and that even though the intention to separate had been unequivocally declared and even though everything else necessary to bring about the disruption of the family had been done, the family would nevertheless be regarded in law as a joint family, only because the family property was not divided by metes and bounds, but the members merely agreed to hold in defined shares, as separated members. It is not necessary for us to express a decisive opinion on this part of the case, as, in our opinion, an unambiguous declaration of intention to separate must, in any case, be proved where it is alleged that the members of a Dayabhag family have become divided in status. The Assistant Commissioner has definitely held that there was no evidence before him of the intention of the Mullick family to separate. We have examined the contents of the deed of partnership dated 14th July 1934, with care and have not been able to find anything which may be indicative of such an intention. Indeed, the recitals of the deed taken at their face value, merely show that S. C. Mullick and his two sons had been members of a firm of partnership ever since S. S. Mullick settled down in Benares. The deed contains no reference to the sons of S. C. Mullick after his death being members of a joint family or otherwise. The deed, to our minds, is consistent with the supposition that the executants of it considered themselves to be members of a joint Hindu family *qua* hardware business and also partners of a firm, which is based on an erroneous view of law. In any case, there is no mention of the fact that the family, which should be presumed to be joint, unless it is otherwise proved, had at any time separated. The Assistant Commissioner has referred to the manner in which the accounts were kept and to other circumstances which gave rise to the inference that the entire family was joint. We have also the additional circumstance that for assessment purposes right up to 1934 the income from the hardware business was treated without objection as the income of a joint Hindu family. The position as regards question No. 1, assuming it is not a pure one of fact but a mixed question of law and fact may be summed up as follows :

The assessee being members of a Hindu family and descendants of the same common ancestor, should be presumed to be joint till the contrary is established. Apart from possible inferences from the recitals in the partnership deed dated 14th July 1931, which are not binding on the Income Tax Department, there is no evidence to rebut the aforesaid presumption. The deed of partnership, if it be assumed to have been executed by members of a joint Hindu family, cannot be considered to have brought into existence a legally constituted firm. It has not been seriously contended before us that persons can, at one and the same time, be members of a joint Hindu family in respect of a joint family property and be also members of a firm of which such property forms the assets. The fact that such a partnership deed has been executed is not *per se* sufficient evidence of the disruption of the joint family, having regard to all the circumstances of the present case. Accordingly we answer the first question in the affirmative.

Having answered the first question in the affirmative, we are clearly of opinion that the Additional Income Tax Officer had evidence before him on which he could hold that no partition had taken place among the members of the family.

We have anticipated, to some extent, in answering the first question, what is our answer to the third question. Having found that the assessee are members of an undivided family and that the property, of which the income is in question, belongs to such family, they cannot be considered to be partners of a firm. The deed and the recitals contained therein may be evidence, even conclusive, as between the parties to it but the Income Tax Department was not bound to accept their correctness and could call upon the executants of the deed to prove the facts recited therein. The Income Tax Officer was at liberty to decide all disputed questions of fact arising before him and we are unable to say that he was not justified, having regard to the materials before him in going behind the partnership deed. We do not think that the third question is very happily worded. As it stands, it gives an impression that, if it is answered in the affirmative, the finding of the Income Tax Officer is affirmed by this Court. So far as it is intended to obtain an expression of opinion by this Court on the question of fact involved in it, it should not have been the subject of a reference under Sec. 66. So far as it relates to the question of law, viz., whether the partnership deed dated the 14th July, 1931, is binding on the Income Tax Department, we have already

expressed our opinion. Subject to these observations our answer to question No. 3 is in the affirmative.

Let the reference and our answers be returned to the Income Tax Commissioner. The costs of this reference shall be paid by the assessees. We certify that the learned advocate for the Income Tax Department has earned a fee of Rs. 200 which shall be taxed if a certificate is filed within six weeks.

Reference answered.

[IN THE NAGPUR HIGH COURT].

SETH KISHAN LAL

v.

COMMISSIONER OF INCOME-TAX, C.P. & U.P.

POLLOCK AND DIGBY, JJ.

September 9, 1937.

BEST JUDGMENT ASSESSMENT—BELATED APPLICATION FOR ADJOURNMENT—SUMMARY ASSESSMENT UNDER SEC. 23 (4) WITHOUT PASSING ORDERS ON APPLICATION FOR ADJOURNMENT—LEGALITY—QUESTION OF LAW—REFERENCE—INDIAN INCOME TAX ACT (XI of 1922), Secs. 23 (4), 66 (3).

The assessee was served with a notice under Sec. 22 (2) requiring him to furnish a return. On the 15th August 1933, his agent applied for 4 months' time, and time was granted till 23rd September 1933. On the 3rd October his agent was asked to file a return at once and an order 'await till 2-11-33', was passed. An application for extension of time dated 26th October 1933, was then sent by registered post to the Income Tax Officer, who without giving any reply to this application, made an assessment under Sec. 23 (4) on 2nd November, 1933. An application to cancel the assessment was also rejected by the Income Tax Officer, and an appeal, by the Assistant Commissioner : Held, that there was no rule under which an Income Tax Officer was bound or ought to announce beforehand how he proposed to deal with an application for adjournment, the assessment was not arbitrary or capricious, and there was no question of law on which the Commissioner could be required to refer under Sec. 66. (3).

COMMISSIONER OF INCOME TAX, C.P. AND U.P. v. BADRIDAS RAMRAI SHOP [1937] (I.L.R. 1937 Nag. 131; 1937 L.T.R. 170) referred to.

Application under Sec. 66 (3) of the Indian Income Tax Act.

JUDGMENT.

This is an application made by Seth Kisanlal under Sec. 66 (3) of the Income Tax Act.

The facts are that on the 23rd July 1933, the applicant Kisanlal was served with a notice under Sec. 22 (2) of the Income Tax Act requiring him to furnish a return of his income in the prescribed form. On the 15th August 1933, his agent applied to the Income Tax Officer for 4 months' time; and he was granted time till 23-9-33. On the 3rd October, it was noted in the order sheet of the case by the Income Tax Officer that his agent had been asked to file the return at once and the order "Await till 2-11-33" passed. An application for extension dated the 26th October 1933 was then sent by registered post to the Income Tax Officer who received it. No reply was given to this application and on the 2nd November 1933, the Income Tax Officer made an assessment under Sec. 23 (4) of the Act.

The assessee then applied to the Income Tax Officer under Sec. 27 of the Act for cancellation of the assessment. The application was rejected though without proper inquiry by the Income Tax Officer. The applicant filed an appeal to the Assistant Commissioner of Income Tax. The Assistant Commissioner considered that sufficient inquiry had not been made but instead of remanding the case proceeded with the consent of the appellant's counsel to enquire into the matter himself and he dismissed the appeal after such inquiry. An application for review of his order to the Commissioner of Income Tax was unsuccessful.

Simultaneously with his application for review to the Commissioner made under Sec. 33 of the Act the assessee asked the Commissioner under Sec. 66 (2) of the Act to refer to the High Court four questions of law alleged to arise out of the appellate order passed by the Assistant Commissioner under Sec. 31 of the Act. The 1st question which the Commissioner refused to refer is framed as follows :—

"In the absence of any evidence indicating that any intimation was received by the assessee or that he ever appeared in Court, was the Income Tax Officer justified in proceeding to assess him *ex parte* without duly intimating to the assessee the order passed on his application and obtaining his acknowledgment of the intimation, :

The 2nd question is " was there no sufficient cause for setting aside the *ex parte* order in the circumstances of the case? "

The view of the Commissioner was that these questions raised points of procedure and facts and not a substantive question of law.

The form of the questions when read with the statement of facts made in the application to this Court is based on 3 allegations : (1) inability to prepare the accounts owing to illness and his munim leaving service. This is a question of fact. (2) Receiving no intimation on the 1st application as to the extension of time till 23-9-33. This is a question of fact which has been found against the applicant. (3) Not attending the Court of the Income Tax Officer. It has been found in the appeal that an intimation of the 1st extension was issued to the petitioner by an intimation card (I.T. 106). It has been found that the story regarding illness is a tissue of falsehood. It has been found that the petitioner had ample time to engage another munim even if his munim had left. These questions raised before the Commissioner when read with the allegations made in the present application were rightly considered by the Commissioner not to be questions of law and we hold that the Commissioner's decision refusing to state a case on the ground that no question of law arose was correct. In argument much has been made of the fact that no reply was sent to the second application received by post the sending of which is incompatible with the allegations of the applicant that his application for 4 months' extension was thought by him to have been granted. If he applied on 15-8-33 and believed his application to have been granted for a four months' extension for 23-7-33, why should he send an application for extension on 26-10-33, by registered post "for one month's time"? The question immediately before us is not whether the Commissioner should have regarded the making of an assessment without replying to this application as a question of law but whether the Commissioner is right in treating the four points as questions of fact and questions of procedure. We are satisfied that the Commissioner's decision was correct and that the questions propounded are nothing more nor less than questions as to whether the Assistant Commissioner rightly or wrongly decided the facts raised in the appeal. We would refer to the decisions of their Lordships of the Privy Council in *Commissioner of Income Tax, U.P. & C.P. v. Badridas Ramrai Shop, Akola* (I.L.R. 1937 Nag. 191) and point out that as regards point no (ii) in that case where a matter was distinctly raised regarding the communication of an

order on request for adjournment, their Lordships stated that they were unaware of any rules under which the Income Tax Officer was bound or ought to announce beforehand how he proposed to deal with an application for an adjournment. Their Lordships evidently regarded that question as part of the general question of fact as is clear from the passage at page 200 and from the passage at page 208 in which the words "if answered at all" appear.

The third question was whether the Income Tax Officer was justified in assessing the assessee on an income of Rs. 51,000 when the assessment for the year preceding was insignificant, on an income just over Rs. 100. This question did not arise out of the appeal and it is not open to the appellant to request the Commissioner to state a case on this point.

The fourth question is as follows:

"Is not the assessment arbitrary, unjust and illegal in the circumstances of the case, where there is no evidence on record or no other material on record to justify the same?" Here again the applicant had no right to ask the Commissioner to state a case as this did not arise out of the appellate order. No appeal lay on these last 2 points to the Assistant Commissioner of Income Tax in an appeal from the Income Tax Officer's order refusing to set aside an *ex parte* assessment. The case has been argued on merits before us as though we had a case stated in front of us. At present the only question which falls for decision is whether we should require the Commissioner to state a case. The application is an application for mandamus. We desire however to add lest it should be thought we are shutting out the application from a full consideration of this case on any narrow grounds, that we are fully satisfied of the correctness of the order of the Commissioner passed on review of the Assistant Commissioner's appellate order by which the order was confirmed. We see no reason whatsoever to believe that the assessment made on the income of Rs. 51,000, was made by the Income Tax Officer without honest exercise of his judgment. It has not been shown in the long argument addressed to us on the merits of the case that the Income Tax Officer made the assessment "dishonestly on vindictively or capriciously or without honest exercise of his judgment (Vide I.L.R. 1937 Nagpur). Complaint has been made that the Commissioner in the review proceedings verified the propriety of the assessment by studying the assessment of previous years. Yet in the decision quoted above this is one of the matters to which an Income Tax Officer should have regard when making assessment under Sec. 23 (4) of the Act to the best of

his judgment". We would also observe that the Commissioner in his order in the review application has fully explained the law as to assessment of the previous year. We would also observe as the point has been raised in argument that the order made by the Commissioner in review was not in any way prejudicial to the assessee in the sense in which those words are used in the proviso to Sec. 33 of the Act or in Sec. 66 (2) thereof, and the complaint made that the Commissioner looked to the previous years' assessments without further hearing the applicant for review has no legal foundation. What happened was that the Commissioner desired to satisfy himself that no injustice has been caused as regards the method of assessment made by the Income tax Officer to the best of his judgment and for this purpose referred to the assessments of the previous years after the arguments arising out of the application for review had been concluded.

The application that we should require the Commissioner to state a case on the ground that it is wrongly held that no question of law arises therefore fails and is dismissed with costs. Pleader's fee Rs. 75.

[IN THE KING'S BENCH DIVISION].

CROSS (INSPECTOR OF TAXES)

v.

LONDON AND PROVINCIAL TRUST LTD.

FINLAY, J.

June 19, July 30, 1937.

INTEREST—INCOME TAX—FOREIGN BEARER BONDS—PAYMENT OF INTEREST SUSPENDED—INTEREST COUPONS MADE EXCHANGEABLE FOR FUNDING BONDS—WHETHER A RECEIPT BY BONDHOLDER OF INCOME OR INTEREST—INCOME TAX ACT, 1918 (8 and 9 GEO. 5, c. 40), SCHED. D, CASE IV.

A company held certain bearer bonds of a foreign country. The Government of that country suspended interest payments, but offered bondholders, in exchange for their interest-coupons twenty-year funding bonds, carrying 5 per cent. interest. The company exchanged their coupons for funding bonds, which they then sold: Held, that the issue of the funding bonds was not a payment of an

equivalent of interest, or a payment of interest in kind, and that the value of the funding bonds at the date of issue was no receipt by the company of interest or of income under Case IV of Schedule D to the Income Tax Act, 1918.

SCOTTISH AND CANADIAN GENERAL INVESTMENT CO. v. EASSON [1922] (S. C. 242; 8 Tax Cas. 256) *distinguished*.

Cases referred to :

CALIFORNIAN COPPER SYNDICATE v. HARRIS [1904] (5 Tax Cas. 159).

INCOME TAX COMMISSIONER v. MAHARAJADHIRAJA OF DARBHANGA [1933] (L. R. 60 Ind. App. 146; 1933 I.T.R. 94).

PAGET v. INLAND REVENUE COMMISSIONERS [1937] (106 L.J.K.B. 881; [1937] 1 K.B. 711).

SCOTTISH AND CANADIAN GENERAL INVESTMENT CO. v. EASSON [1922] (S. C. 242; 8 Tax Cas. 265).

Appeal by Case stated against a decision of the Commissioners for the Special Purposes of the Income Tax Acts.

The following facts appeared upon the case stated: The respondent company appealed to the Special Commissioners against assessments made on them of £ 275-10s. for 1933-34 and of £ 390 for 1934-35 in respect of profits described as "Case IV". The assessments were made by the Additional Commissioners for the City of London.

Among the investments held by the company were certain bonds issued in 1926 by the United States of Brazil in denominations of 500 or 1,000 dollars and described as "6½ per cent. External Sinking Fund Gold Bonds of 1926", which bonds were due for repayment on October 1, 1957. Coupons were attached to them which provided for the payment of interest on April 1, and October 1, in every year during their currency.

Early in 1932 the Brazilian Government gave notice that they were suspending payment of interest on those bonds. In March, 1932, agents of that Government in London issued a circular relating to those dollar bonds as well as others, the circular being headed "United States of Brazil Funding Plan" and containing *inter alia* the following terms: "The Government of the United States of Brazil has found itself compelled to suspend payment of interest and sinking fund on the loans mentioned below. It has therefore decided to fund the interest payable on these loans during a period not exceeding three years..... The Minister of Finance..... has authorised the issue for this purpose

of two series of funding bonds to be called 'United States of Brazil 5 per cent. twenty-year Funding Bonds of 1931' and United States of Brazil 5 per cent. forty-year Funding Bonds of 1931' respectively. The twenty-year bonds will be divided into sterling, U. S. dollar and French franc tranches, and the forty-year bonds into sterling and French franc tranches, each tranche of each series being secured by a separate general bond. Sterling, dollar and franc Coupons" attached to the 6½ per cent. Dollar Bonds of 1926 and which were to bear interest for April 1, 1932, to October 1, 1934, inclusive) "may be exchanged, when and as they mature, for an equal amount of twenty-year bonds, of the appropriate tranche. Each series of bonds will carry interest at 5 per cent. per annum. Interest will be payable half-yearly on April 1 and October 1 in every year. All the bonds will be payable to bearer. The dollar bonds will be issued in bonds of 1000, 500 and 100 dollars. The following are the conditions to be observed by holders of bonds of the suspended sterling loans for the funding of coupons: (a) Coupons to which the funding plan applies may be presented for funding at the office of "the agents in London of the Brazilian Government" and at the office of "a bank in Paris, "and at the offices in the other places (except New York and Zurich) at which such coupons are payable, on dates of which notice will be given by advertisement in the usual manner. (b) In exchange for coupons holders will receive receipts for the amount lodged. (c) These receipts will be exchangeable for scrip, which will be afterwards exchangeable for bonds of the appropriate series". Those conditions were although expressed to be applicable to the sterling loans, in fact applied also to the dollar loans.

The respondent company duly surrendered the coupons attaching to its 1926 bonds as they fell due in accordance with the conditions in that letter, and in due course received funding bonds in exchange for the coupons surrendered. The company from time to time sold the funding bonds which it received. It was admitted that they were of marketable value when they were received. The company's revenue accounts for the years 1932-33 and 1933-34 included sums representing the proceeds of sale of the funding bonds. The assessments in question were made under Case IV of Schedule D to the Income-tax Act, 1918, to include the value of the funding bonds at the time of their issue. No question of amount arose.

Before the Special Commissioners it was contended for the respondent company that the Brazilian Government had made no

payment whatsoever, and that no income had arisen to the company within the meaning of Case IV of Schedule D to the Income Tax Act, 1918.

It was contended for the Crown that the funding bonds represented money or money's worth; that they were received in satisfaction of the interest due from that Government, and that they were income arising from securities within the meaning of Case IV of Schedule D.

The Special Commissioners discharged the assessments, giving the following decision: We do not think that *Scottish and Canadian General Investment Co. v. Elasson* affords us guidance. Apart from the fact that the assessment in that case was under Case I of Schedule D, the 'payment' of interest was made in securities of another company. The present assessments are defended under Case IV of Schedule D. To satisfy that case there must be income arising abroad. There clearly has been no payment of interest by the Brazilian Government out of its public revenue, to use the words appropriate to Schedule C (under which the assessment would then fall to be made), and we are unable, after considering all the facts, to see that there has been any payment of income from abroad at all within the scope of Case IV. All that has been done is that the appellants, being the owners of coupons which are unpaid, have received a bond bearing interest for the amount unpaid, and we cannot regard this transaction as income arising from securities abroad within Case IV. We express no opinion on this appeal as to the possibility of assessments under other Cases of Schedule D. We accordingly discharge the assessments".

The Crown appealed.

The Attorney-General (Sir Donald Somervell, K. C.) and *R. P. Hills* for the appellant.

Latter, K. C., and *Scrimgeour*, for the respondent.

JUDGMENT.

FINLAY, J.,—This case, like *Paget v. Inland Revenue Commissioners* depends to a large extent on Case IV of Schedule D, which Case has reference to: "Tax in respect of income arising from securities out of the United Kingdom." (His Lordship read the case stated, and continued:)

Two cases were referred to before me. In *Scottish and Canadian General Investment Co. v. Elasson* a company, as the head-note in Reports of Tax Cases states, held certain 5 per cent. mortgage bonds of the Western Canada Power Company, Limited. That company was unable to meet the coupons which fell due for

payment on January 1, 1916, in respect of the interest on the bonds for the half year from July 1, 1915. A reorganisation of the finance of the company, involving the formation of a new company, then took place, and the appellant company surrendered its holding of bonds of the old company, with the unpaid coupons attached, and received in exchange 5 per cent. bonds of the new company of equivalent face value, bearing interest from July 1, 1917, together with an issue of 10-year 7 per cent. debentures of the new company, equal in face value to 10 per cent. of the face value of the surrendered bonds. The 7 per cent. debentures issued to the appellant company under this arrangement were thus exactly equivalent in face value to the amount of the coupons for the two year's interest from July 1, 1915, to July 1, 1917, which had been surrendered with the bonds of the old company, but in the scheme of reorganisation it was not expressly stated that these debentures were in satisfaction of the arrears of interest. In computing for the purposes of assessment to income tax, Schedule D, the profits of the appellant company for the year during which it had received the 7 per cent. debentures, a sum equal to 75 per cent. of the face value of those debentures as representing their actual value at the time of receipt by the company, had been included as interest received". The headnote continues: "*Held*, that the Commissioners had evidence before them sufficient to enable them to arrive at their determination that the 7 per cent. debentures represented the two years' interest coupons which had been surrendered with the old bonds, that the value of the debentures had therefore been properly included in the computation of the company's profits, and that, as objection had not been raised upon the appeal to the basis adopted in valuing the debentures, the Court had no material upon which to question the Commissioners' finding that 75 per cent. of the face value of the debentures fairly represented the profit of the appellant company.

The question in the case was considered in the Inner House by the Lord President (LORD CLYDE), and the substance of his view comes to this (1922 S. C. at p. 246; 8 Tax Cas. at p. 271). "The question becomes one of ascertaining the amount of the profits and gains of the company. If, instead of receiving cash for the coupons on the old bonds, the company got a saleable security, that saleable security is just part and parcel of the company's profits and gains". For myself I do not question for a moment that general principle. I think that if by way of profit, instead of receiving money, you receive money's worth, no doubt that

money's worth is to be regarded as money and falls to be brought in for purposes of assessment. That is really what was decided in that case.

The second case referred to before me was *Income Tax Commissioner v. Maharajadhiraja of Darbhanga*. LORD MACMILLAN delivered the decision of the Privy Council, and one point which he considered has some bearing on the question which I have to consider, because there a question arose whether certain promissory notes were or were not to be regarded as income. Lord Macmillan said (L. R. 60 Ind. App. at p. 161): "The Commissioner's opinion was that the transaction when rightly viewed amounted to the acceptance by the assessee from his debtor, in lieu and satisfaction of the capital and interest due to him, of assets and securities *prima facie* worth the valuation put upon them and that as the assessee had thus received payment in kind of the interest due to him in full, he should be assessed accordingly. There is, of course, no doubt that a liability to pay interest, like a liability to make any other payment, may be satisfied by a transference of assets other than cash and that a receipt in kind may be taxable income. But for this to be so it is essential that what is received in kind should be the equivalent of cash or, in other words should be money's worth—*Californian Copper Syndicate v. Harris; Scottish and Canadian General Investment Co. v. Easson*. Now here the first six items amounting to Rs. 20,74,973 may perhaps reasonably enough be regarded as the equivalent of cash, but the seventh item of Rs. 17,34,596, consisting of the debtor's own promissory notes was clearly not the equivalent of cash. A debtor who gives his creditor a promissory note for the sum he owes can in no sense be said to pay his creditor: he merely gives him a document or voucher of debt possessing certain legal attributes. So far, then, as this item of Rs. 17,34,596 is concerned the assessee did not receive payment of any taxable income from his debtor or indeed any payment at all. In so holding their Lordships find themselves in agreement with the learned Judges of the High Court who differed on this point from the Commissioner".

There is no doubt at all in the present case that these bonds were things of value, as is shown by the fact that they were things which could be sold and in fact were sold in the market. The question does not seem to be, on the case before me whether the bonds were things of value. The question is whether there was anything analogous to interest. A person receiving the bonds in these circumstances, is not, I think, receiving interest, or indeed

receiving income. The whole point seems to me to be that Brazil, unfortunately, was unable to pay interest, and so evolved its scheme of issuing these bonds : and, from the point of view of the recipient, the result of the transaction was that he received, instead of interest, a capital asset. That capital asset, if the obligations under it were duly fulfilled, would itself produce income and would result in income, which, if and when it were received would be liable to tax. I do not think that it can be said (and in this I agree with the Commissioners) that here there is a receipt of interest or a receipt of any income under Case IV. The whole point is that there was no income and that the capital asset was, so to speak, substituted for the income. I cannot regard this as being a payment of an equivalent of interest, a payment of interest in kind, so as to fall within the decision in *Scottish and Canadian General Investment Co. v. Elasson*.

I have arrived at the conclusion that the view taken by the Commissioners in the present case was correct. The appeal therefore fails and is dismissed with costs.

Appeal dismissed.

[IN THE KING'S BENCH DIVISION].

PAGET v. INLAND REVENUE COMMISSIONERS.

FINLAY, J.

June 14, 15. July 30, 1937.

INCOME-TAX AND SURTAX—FOREIGN BEARER BONDS—INTEREST PAYABLE IN STERLING OR DOLLARS—NORMAL PAYMENT SUSPENDED—OFFER OF PAYMENT SUBJECT TO RESTRICTIONS IN CURRENCY OF COUNTRY OF ISSUE—SALE BY BONDHOLDER OF INTEREST COUPONS IN LONDON MARKET—PROCEEDS OF SALE—WHETHER “INTEREST”—WHETHER CHARGEABLE WITH TAX—INCOME TAX ACT, 1918 (8 AND 9 GEO. 5, c. 40) Sched. D, Case IV.

A taxpayer held bearer bonds issued in two different European countries, interest being payable in the first case in sterling and in the second in dollars. In the first case payment of interest in sterling was suspended by governmental decree, the corresponding amount of interest in currency of the country being directed to be deposited with a bank there, and payment of interest in that currency only being obtainable subject to restriction as to its use. In

the second case payment of interest in dollars was suspended, payment of interest being offered either in the foreign country in its currency and subject to restrictions or, as to 10 per cent. in dollars and, as to the balance, in funding bonds. The bondholder in each case sold the interest coupons attaching to the bonds in the London market : Held, (a) that there was not in either case any payment of interest on the bonds to the bondholder. Simpson v. Maurice's Executors (1929) (45 T.L.R. 581 ; 14 Tax Cas. 580) distinguished.

Where interest coupons are sold, and interest is then received by the purchaser, the tax must be borne by the purchaser by deduction or otherwise, and the fact that he will have to do so will be reflected in the purchase price. The fact that he will pay less for the coupons because he must pay tax on the interest when he receives does not cause the vendor of the coupon to bear the tax. If there is interest, it is taxed wherever it is found. Accordingly, Held, (b) that the proceeds of the sale of the interest coupons ought not to be brought in for purposes of the bondholder's assessment to tax.

Case referred to :

SIMPSON v. MAURICE'S EXECUTORS [1929] (45 T.L.R. 581 ; 14 Tax. Cas. 580).

Appeals by case stated from a decision of the Commissioners for the Special Purposes of the Income Tax Acts.

At a meeting of the Special Commissioners held in January 1936, the taxpayer, Miss Paget, appealed against an additional assessment to surtax made on her for the year ending April 5, 1933, of £ 1,960 (of which assessment £ 787 was not in dispute), and against an assessment to surtax for the year ending April 5, 1934, in the estimated sum of £ 50,000.

The following facts appeared upon the case stated during the two years of assessment: the taxpayer held certain $4\frac{1}{2}$ per cent. bearer bonds issued by the city of Budapest in 1914 with interest coupons falling due for payment on July 1 and January 1 in every year. It was a term of the bonds that the interest coupons were payable in London in sterling and in various other countries in their respective currencies.

By Article 1 of Decree No. 6900 of the Royal Hungarian Government dated December 22, 1931, a translation of which was circulated to bondholders by the Department of Overseas Trade in a letter dated January 2, 1932, the municipality of the city of Budapest was forbidden during the currency of the decree (but without prejudice to the full rights of creditors after its expiry) to make payments of interest on bonds on the creditors, but was directed

deposit with the Hungarian National Bank, as such payments fell due, the equivalent in pengos of the sum owed. By article 2 of the decree, provision was made for the formation of a Foreign Creditors' Fund into which payments of pengos should be made and for the control of that fund by the Hungarian National Bank. The decree came into force on December 23, 1931, and expired on December 22, 1934.

After the decree had come into force, payment of interest coupons attaching to the bonds could be obtained in Hungary in pengos, but the payment could only be made out of the sums in pengos deposited by the city of Budapest pursuant to the decree to the credit of an account controlled by the Hungarian National Bank. The proceeds of coupons thus paid could only be released with the sanction of the Hungarian National Bank and provided that the proceeds were not required for certain specified purposes in Hungary itself. The taxpayer did not obtain any such release.

There was a market in London for the sale of the interest coupons attaching to the bonds in question. During the two material years of assessment, the taxpayer effected sales of coupons through agents or coupon dealers in London. The sales amounted for the respective year to £1,172 10s. and £1,564 7s. 8d. gross. The agents or dealers deducted income tax from the proceeds on paying them to the taxpayer.

During the second of the two years of assessment, the taxpayer held certain 7 per cent. bearer bonds of the Kingdom of Yugoslavia issued in 1922, with interest coupons falling due for payment on May 1 and November 1 in every year. The coupons were payable in American dollars in New York. In a circular letter dated July 24, 1933, and addressed *inter alia* to the bondholders the Yugoslavian Government through its Consul-General in New York expressed inability to pay the interest on the bonds in full, and submitted to the bondholders a scheme for meeting the coupons maturing from November 1, 1932, to May 1, 1935, under which holders might accept either (a) payment of each coupon in dinars in Belgrade, the disposal and use of the dinars being governed by the general legislative or regulatory provisions of Yugoslavia from time to time in force with regard to transactions in moneys and foreign exchange, or (b) payment of 10 per cent. of the face value of each coupon in American dollars and the issue of funding bonds for the balance of the value.

In September, 1933, the tax payer sold the interest coupons attaching to her bonds and falling due for payment on November 1,

1932, and May 1, 1933, through agents or coupon dealers in London. The nominal amount of the coupons was 7,000 dollars, the amount realised being 3,587.50 dollars, or £ 760 1s. 3d. The dealers or agents deducted income tax from the proceeds of the sale, crediting the balance to the taxpayer's banking account in Montreal.

It was contended for the taxpayer: (1) that no interest arose to her from any of the bonds in either of the material years of assessment, the deposit of pengos with the Hungarian National Bank by the Municipality of Budapest in pursuance of the decree not being a payment to her, and the offer by the Yugoslav Government not having been accepted, and no payment from that Government having been received by her: (2) that the proceeds received by her from the sale of coupons were not interest but merely the price of the expectancy of interest, and accordingly not her income; (3) that the proceeds of the sale of coupons did not arise to the taxpayer from the bonds but from contracts of sale: and (4) that she was not liable to pay or bear income tax on the proceeds of the sales of coupons under Schedule C or Schedule D to the Income Tax Act, 1918, or at all, and that therefore those proceeds did not form part of her income for purposes of surtax.

It was contended for the Crown that the proceeds of the sale of the coupons were income and fell to be included as the taxpayer's income in the assessments against which she appealed.

The Special Commissioners confirmed the assessment for 1932-33, and reduced to £ 26,307 that for 1933-34, having delivered the following written decision:

"We hold that the 4½ per cent. City of Budapest Bonds are instruments" subject to Hungarian law and capable of being affected by the decrees of the Hungarian Government. In our opinion the deposit of pengos with the Hungarian National Bank in accordance with Decree No. 6900 constituted performance by the municipality of its obligation to pay interest on the bonds, and the proceeds of the coupons falling due at the respective dates of deposit represent interest arising to the appellant and must be included in her return of total income for the purposes of surtax.

"As regards the 7 per cent. bonds of the kingdom of Yugoslavia, interest coupons of which fell due for payment on November 1, 1932, and May 1, 1933, we hold that there was default on the part of the Yugoslav Government and that the offer to pay in dinars or partly in United States dollars and partly in funding bonds did not, in the absence of acceptance by Miss Paget and payment to her constitute performance or satisfaction of its obligation. In our

opinion the sale of the coupons did not amount to an implied acceptance of this offer and the mere fact that the existence of the offer gave some value to the coupons in the market did not cause interest to arise. We therefore exclude this item from the assessments for the years 1932-33 and 1933-34 ”.

The taxpayer appealed on the first question and the Crown cross-appealed on the second.

Latter, K. C. and F. Grant, for the taxpayer.

The Attorney-General (Sir Donald Somerwell, K. C.) and R. P. Hills, for the Crown.

July 30—FINLAY, J., delivered the following written judgment: These are appeals from a decision of the Special Commissioners relating to two separate sets of bonds, and each side appeals from the decision at which the Commissioners arrived. The appellant in the first case is the Honourable Dorothy Wyndham Paget, who is the respondent in the other case. The facts are quite clearly set out in the Case stated, and they relate to two separate sets of bonds of which Miss Paget at the material time was the owner. They were bonds of the City of Budapest and bonds of the Kingdom of Yugoslavia.

(His Lordship, having read the case stated, continued:) It is, no doubt, necessary to consider under what Schedule, if any, to the Income Tax Act, 1918, these things are taxable. In my opinion, they were, if anything, income from foreign securities under Case IV of Schedule D. A suggestion was made that they might fall under Schedule C. I do not think that that suggestion is well founded, but some reliance was placed on rule 7 of the Rules applicable to that Schedule. That rule is, in my opinion, mere machinery, and does not really help.

The main question (and on this, I think, counsel were agreed) is whether these sums are income arising from the value of the securities. The word, it is worth nothing, is “income” and not “interest”. I shall consider later whether that really matters. Much of the argument before me, and also, judging from their decision, before the Commissioners, was on the question whether the sums were interest. The Commissioner’s decision was, as I have already said, that there was interest in the first case but not in the second. I do not think that in the first case the Commissioners can be right. It seems to me that the argument of counsel for the taxpayer was correct, that the deposit of pengos in the Hungarian National Bank cannot be regarded as a payment of interest to her. The Hungarian National Bank were in no sense

agents of Miss Paget to receive money on her behalf, and the case differs altogether, I think, from *Simpson v. Maurice's Executors*, where the German Bank or banks concerned were the agents of Mr. Bonner Maurice or of the testator in that case and were duly authorised to receive money on his behalf. Here there is no authority whatever, either express or implied from Miss Paget to the Hungarian National Bank to receive money on her behalf and on that ground I think that the decision—obviously a very carefully considered decision—arrived at by the Special Commissioners on that matter was erroneous.

As regards the Yugoslav bonds, I agree with the conclusion of the Commissioners. I do not think that there was there a payment of interest to the appellant. An offer was made, which if it had been accepted, would or might have resulted in payment to her: but she did not accept. I am, therefore, of opinion that there was in neither of these cases any interest paid to or accepted by the taxpayer.

I desire to add that the view which I think right concludes the matter. The view which I take is that the sums which Miss Paget received were simply the purchase price of coupons, and that in no sense, therefore, was there income from foreign securities. The matter is one of some difficulty, and various cases may no doubt be put. There is the simple case where a coupon is presented and interest received by the holder, and no one doubts there that there is interest, and that is taxable. Equally so, if a banker or other agent presents the coupon on behalf of the holder. But if coupons are sold, and interest is then received by the purchaser, I think there that it is a sale and purchase, and a receipt of interest by the purchaser. The tax, it seems to me, has there to be borne by the purchaser by deduction, or by direct assessment, and the fact that purchaser will have to bear tax will be reflected in the purchase price. He will consider, in deciding what he will pay for the coupon, that he has to bear tax on the interest when he receives it: but the tax, is, of course, paid once and once only. It is paid, in the case I am putting, by the purchaser of the bond, and the fact that he will pay less for the coupon because he has to pay tax on the interest when he receives it does not cause the vendor of the coupon to bear tax. Another case may be put—an imaginary case: suppose that three months before the due date, coupons for two sets of bonds A and B are sold, that the interest on A is paid three months later, and that the interest on B is not paid. It seems to me clear that, in such a case, the

vendor receives the purchase price only. In the one case, taxation arises because, and only because interest is received, and the taxation is borne by the purchaser. In the other case, the case where in fact the interest is not paid and there is a repudiation of liability, a failure to pay, then there is no taxation because there is no interest received. The substance of the matter seems to me to be that if there is interest wherever it is found, it is taxed. But if it is the purchase price of a coupon and not interest, then it is not liable to taxation. The interest will, of course, be liable to taxation if and when it is paid.

My conclusion, therefore, is that in the first case the Commissioners were wrong, because the payment in pengos to the Hugarian National Bank cannot constitute a receipt of interest by Miss Paget. In the second case I think that the Commissioners were right in finding that there was no receipt of interest. The result, therefore, is that the appeal of Miss Paget must be allowed and the appeal of the Crown dismissed.

Appeal allowed : cross appeal dismissed.

[IN THE BOMBAY HIGH COURT].

COMMISSIONER OF INCOME TAX, BOMBAY

v.

THE MAZAGAON DOCK LTD.

SIR J. W. F. BEAUMONT, C. J., BLACKWELL, J., and RANGNEKAR, J.

October 15, 1937.

DEPRECIATION ALLOWANCE—TRANSFER OF BUSINESS—ASSESSMENT OF SUCCESSOR UNDER SEC. 26 (2) ON PROFITS MADE BY PREDECESSOR—ALLOWANCE, WHETHER TO BE CALCULATED ON ORIGINAL COST TO PREDECESSOR OR TO SUCCESSOR—‘ASSESSOR’, MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 10 (2) (vi), 26 (2).

A firm called the Masagaon Dock were carrying on the business of shipbuilders and repairers in Bombay until 31st March 1935. From the 1st April 1935 the assesses, a new limited company called the Masagaon Dock Ltd., took over the business of the firm including its buildings, machinery, plant etc. and in the assessment

for the income of the year ended 31st March 1935, on the assessee as successors of the old firm under Sec. 26 (2) of the Indian Income Tax Act, the assessee claimed that in view of the provisions of Sec. 26 (2) of the Act, depreciation allowance on the building, machinery plant etc., should be calculated on the original cost to the old firm the profits of which were being assessed, and that in addition thereto all the unabsorbed depreciation due to the firm should also be allowed under proviso (b) to Sec. 10 (2) (vi) of the Act. The income tax authorities held that depreciation could be allowed only on the original cost to the assessee company in view of the wording of Sec. 10 (2) (vi) and the decision of the Privy Council in Buckingham and Carnatic Co's Case [1935 I.T.R. 384]. On a reference made by the Commissioner of Income Tax, Bombay :

Held, per SIR JOHN BEAUMONT, C. J., and RANGNEKAR, J. (BLACKWELL, J., dissenting):—that where a person carrying on a business, profession or vocation has been succeeded in such capacity by another person and an assessment is made on the successor under Sec. 26 (2) of the Indian Income Tax Act, on the profits of the predecessor, the word 'assessee' in Sec. 10 (2) (vi) of the Act must be construed as referring to such predecessor, and depreciation allowance should be calculated on the original cost to the predecessor and not to the successor. The decision of the Privy Council in Buckingham and Carnatic Co.'s Case does not apply to the case of an assessment under Sec. 26 (2).

BLACKWELL, J., (contra): The reasoning of the Privy Council in Buckingham and Carnatic Co.'s Case is applicable equally to the case of assessment on a successor under Sec. 26 (2) and the depreciation allowance should accordingly be calculated even in such cases on the original cost to the successor.

COMMISSIONER OF INCOME TAX, MADRAS v. BUCKINGHAM & CARNATIC CO., LTD. [1935] (59 Mad. 175; 1935 I.T.R. 384; 9 I.T.C. 114) distinguished.

COMMISSIONER OF INCOME TAX, BOMBAY PRESIDENCY v. SARAPUR MILLS LTD., [1931] (I.L.R. 56 Bom. 129) referred to.

Reference made by the Commissioner of Income Tax, Bombay Presidency, under Sec. 66 (2) of the Indian Income Tax Act in the matter of the assessment of the Mazagaon Dock Ltd., for the assessment year 1935-36, [Civil Ref. No. 10 of 1937].

The Commissioner's Statement of the case was as follows :

STATEMENT OF CASE.

Under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922, (hereinafter referred to as "the Act"), and at the instance of the

Mazagaon Dock Limited, (hereinafter referred to as "the Company") I have the honour to refer for your Lordships' decision the question of law set out in paragraph 6 below, which has arisen out of the income tax and super tax assessment of the Company for the financial year 1935-36, ended on 31st March 1936.

2. **Facts of the case.**—The above named Company is doing business in Bombay as shipbuilders and repairers. The said business was carried on by a partnership firm known as the Mazagaon Dock but from 1st April 1935, that partnership has been converted into a limited company.

3. As from the aforesaid date, the business of the old partnership was taken over by the Company, under Sec. 26 (2) of the Act, the Income Tax Officer, Companies Circle, assessed the Company for the financial year 1935-36 on the profits earned by the firm in the year ended 31st March 1935 which was the "previous year" of the firm as defined in Sec. 2 (11) of the Act. While assessing income under the head "business", an allowance on account of depreciation of machinery, plant and buildings is to be granted at the prescribed rates as laid down in Section 10 (2) (vi) of the Act which reads as follows:—

"(1) Such profits or gains shall be computed after making the following allowances namely:—

"(vi) In respect of depreciation of such buildings, machinery, plant or furniture, being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed:

"Provided that—

(a) the prescribed particulars have been duly furnished;

(b) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or if there is no such allowance for that year, be deemed to be the allowance for that year and so on for succeeding years; and

(c) the aggregate of all such allowances made under this Act or any Act repealed hereby or under the Indian Income Tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant or furniture as the case may be".

As laid down in the above section, depreciation is to be allowed at the prescribed rates "on the original cost to the assessee" and with respect to this question, the Company claimed that the allowance should be computed on the original cost to the old firm and not to the Company and that in addition thereto, all the unabsorbed depreciation due to the former under the proviso (b) to the above Section 10 (2) (vi) of the Act should also be allowed, as in its opinion, Section 26 (2) of the Act required that to be done. The Income-tax Officer, however relied on the judgment of the Privy Council in the case of *The Commissioner of Income-tax, Madras v. Buckingham and Carnatic Co. Ltd.* (I.L.R. 59 Madras 175) and computed the total depreciation allowable at Rs. 51,929, taking into account the original cost to the company itself as it was the assessee and not the old firm. He thus assessed it on an income of Rs. 2,36,986, under his Assessment Order dated 2nd October 1936, a copy of which is annexed hereto, marked Exhibit A. Had this allowance been computed on the original cost to the defunct firm and if the unabsorbed depreciation allowance was added thereto, the total allowance for depreciation would have exceeded the total assessable income and the Company would have been exempted.

4. Against the above order of the Income-tax Officer, the Company appealed to the Assistant Commissioner of Income-tax, B Division, Bombay, by its petition of appeal dated the 27th November 1936, a copy of which is annexed hereto marked Exhibit, B. The Assistant Commissioner heard the appeal and disallowed the contention put forward and confirmed the assessment by his order dated the 4th January 1937. A copy of the said order is annexed hereto marked Exhibit, C.

5. Thereupon the Company has applied to me requesting me to refer the matter to this Honourable Court under Section 66 (2) of the Act. A copy of the petition is annexed hereto and marked Exhibit, D. I have accordingly drawn up this Statement of the case.

6. Question for the decision of the Honourable Court. I submit for favour of decision the following question of law :—

"Whether in the circumstances of the case, the Income-tax Officer has correctly computed the depreciation allowance under Section 10 (2) (vi) of the Act on the original cost to the assessee Company itself, notwithstanding the fact that it was being assessed under Section 26 (2) of the Act as the successor to the partnership firm known as the Mazagaon Dock."

7. **Opinion of the Commissioner.**—As Sect 66 (2) of the Act requires me to give my opinion while submitting this Reference, I beg to submit that, following your Lordships' decision in the case of the *Sarsapur Mills Co. Ltd.*, (56 Bom. 129) referred by me to this Honourable Court in the year 1931 and the more recent decision of the Privy Council in the case of the *Commissioner of Income tax, Madras v. Buckingham and Carnatic Co., Ltd.* (59 Mad. 175), the answer to the question put must be in the affirmative. The wording of Section 10 (2) (vi) is quite clear and unambiguous and it requires the depreciation allowance to be computed on the original cost "to the assessee". Under Sec. 2 (2) of the Act, the word "assessee" means "a person by whom income-tax is payable". Who is the person by whom the amount of income-tax levied in the case is payable? Is it the Company or the old firm? Undoubtedly it is the Company and not the old firm. The Company relies on Sec. 26 (2) of the Act but the very fact that that section provides that the assessment should be made on the Company and not on the old firm leaves no doubt that "the assessee" referred to in Sec. 10 (2) (vi) is the Company itself and that the allowance is to be computed on the original cost to it as required by that section.

8. Turning again to Sec. 26 (2) of the Act on which the whole case for the Company is based, it lays down that when a person carrying on business "has been succeeded in such capacity by another person the assessment shall be made on such person succeeding as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year". What the section lays down is merely this that the assessment must be made on the successor on the supposition that he was carrying on the business throughout the previous year and received the profits therefor. The Company is thus to be made the assessee and to be assessed on the basis that it had during the year ended 31st March 1935, carried on the business and received all the profits. If we are thus to treat the Company as having carried on the business in the said year ended 31st March 1935 and as having received the profits therefor, it is, I submit, impossible for the old firm to come into the matter of the computation of the depreciation allowance under Sec. 10 (2) (vi) of the Act. It is the Company which is to be assessed under Sec. 26 (2) and everything is to be done on the footing that it came into existence a year earlier. The section virtually requires the circumstance that during the "previous

year " it was the firm that had in fact carried on the business to be disregarded and the assumption to be made that the firm had already disappeared and that the Company was carrying on the business. The contention of the Company would have had some force if Sec. 26 (2) had laid down that the profit was to be computed on the supposition that at the time of assessment, the defunct firm was still in existence. It does not say so. Had the section merely provided that the assessment should be made on the person succeeding to the business as if he had received the whole of the profit of the previous year, it might with some force have been contended that these profits should be computed as they would have been computed had the business been carried on by the retiring owner. But that is not the section. The further assumption above emphasised is also to be made. It is submitted therefore that Sec. 26 (2) in every way supports the decision of the Income Tax Officer and not the contention of the Company.

9. A copy of your Lordships' decision may kindly be certified to me for further action as required by Sec. 66 (5) of the Act.

The *Advocate-General* with the *Government Solicitor* for the Commissioner.

Coltman with Messrs. *Craigie, Blunt and Caroe* for the Assesseees.

JUDGMENT.

BEAUMONT, C. J.—This is a Reference made by the Income tax Commissioner under Sec. 66 (2) of the Indian Income-tax Act raising the question, whether in the circumstances of the case, the Income-tax Officer has correctly computed the depreciation allowance under Sec. 10 (2) (vi) of the Act on the original cost to the assessee Company itself, notwithstanding the fact that it was being assessed under Sec. 26 (2) of the Act as the successor to the partnership firm known as the Mazagaon Dock.

The facts giving rise to the Reference admit of no doubt. The year of assessment is the year 1935-36, so that the previous year expired on the 31st March, 1935. On the 1st April 1935, the assesseees, the Mazagaon Dock Ltd., acquired from a firm known as the Mazagaon Dock the assets of that firm. The assesseees made a return of their income for the year ending 31st March 1935, based on the profit and loss account for that year of the vendor firm, the assesseees themselves having no income for the year ending 31st March 1935. The assesseees claimed to deduct from the profits made by the vendor firm during the previous year the allowance for depreciation which would have been permissible

to the vendor firm had they not disposed of their business. The Commissioner of Income-tax disallowed the claim, and the question is whether his decision is right.

The position turns upon the construction of Sec. 26 (2) read with Sec. 10 of the Income-tax Act. Sec. 26 was introduced by an amending Act passed in the year 1928, the previous section having been couched in much more general terms, though probably its effect was much the same as that of the amending section. By sub-section (2) of the existing section it is provided that "where at the time of making an assessment under Sec. 23 it is found that the person carrying on any business, profession or vocation, has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year". In the absence of authority to the contrary it would certainly seem that in calculating the profits for the previous year, deduction to which the predecessor would have been entitled must be allowed. In the case of a business (and the present assessment relates to a business) Sec. 10 (2) provides that the profits or gains shall be computed after making the following allowances. The income therefore is ascertained only after deduction of the allowance. The first allowance is in respect of rent paid for the premises in which such business was carried on, which must mean the premises in which the predecessor's business was carried on, and there is a proviso that when any substantial part of the premises has been used as a dwelling house by the assessee there is to be a deduction from the allowance. "Assessee" in that clause must, I think, mean the predecessor of the actual assessee, on whose profits the assessee is being assessed. The successor in the present case who is being assessed was not in existence during the year 1934-35 and could not have occupied the premises. The next allowance is in respect of repairs where the assessee is the tenant only of the premises and has undertaken to bear the cost of such repairs. Here again, "the assessee" must mean the predecessor of the person being assessed, who would be the tenant and person liable for the repairs. The third allowance is in respect of capital borrowed for the purposes of the business, and there again the business must be that of the predecessor. Then sub-paragraph (vi) is the one material for the purposes of the present reference. That sub-section authorises an allowance in respect of depreciation of buildings, machinery

plant or furniture, being the property of the assessee, of a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed. In the absence of authority I should say that "assessee" in that sub-clause, in the case of an assessment under Sec. 26 (2) based on the profits of a predecessor, must refer to such predecessor. Otherwise in the present case no effect can be given to the allowance, since during the year under assessment, the property did not belong to the actual assessee, nor had the cost thereof to him been ascertained. It is true that the construction which I am suggesting of Sec. 10 involves some extension of the definition of "assessee" contained in Sec. 2 (2) of the Act so as to make the word include not only a person by whom income tax is payable but also a person on whose income, profits or gains an assessment is being based. It is to be noted that the definitions in the Act are to yield to the context. The Court has to construe the Income Tax Act as a whole and the only alternative to the construction of Sec. 10 which I suggest is to hold that in the case of an assessment under Sec. 26 (2) the assessee can claim no allowance in respect of depreciation of buildings, machinery, plant or furniture. This in my view is not the true meaning of the Act. I may observe that a similar difficulty would arise under Sec. 11 in the case of the assessment of the profits of a profession or vocation under Sec. 26 (2).

The Advocate-General has not seriously contended that any other rational construction can be given to Sec. 10 as applied to an assessment under Sec. 26 (2), but he says that the words of Sec. 10 read with the definition of "assessee" are plain and must be given effect to, whatever the consequences, and further that the case is covered by the decision of the Privy Council in *Commissioner of Income Tax, Madras v. The Buckingham and Carnatic Co., Ltd.* (1935) I.L.R. 59 Mad. 175. It is necessary therefore to see exactly what that case decided. Before the decision of that case there had been a difference of opinion between High Courts in India as to the construction to be placed upon Section 10 (2) (vi). The High Court of Madras considered that the original cost to the assessee referred to in that sub-section was the original cost to the vendor and not the actual assessee, whereas this High Court and High Court of Patna had held that the original cost was the original cost to the actual assessee, viz., the purchaser: see *Commissioner of Income Tax, Bombay v. The Saraspur Mills Co., Ahmedabad* (1931) I.L.R. 56 Bom. 129, and *Motiram Roshan Lal Coal Co. v. Commissioner of Income Tax* (1932) I.L.R. 12 Patna 12. In the

Buckingham and Carnatic Co. case the Privy Council decided in favour of the view taken by this High Court and the High Court at Patna, and it is therefore clearly settled that in respect of all subsequent assessments upon the present assessee depreciation will have to be based on the price paid by the assessee to Mazagaon Dock, and not on the original cost to the Mazagaon Dock. But in none of the cases referred to did the question arise in relation to an assessment under Sec. 26 (2) in respect of the year previous to the purchase. It would appear from a statement made by the Commissioner of Income Tax in *Motiram Roshan Lal Co., Ltd. v. Commissioner of Income Tax* (1932) I.L.R. 12 Pat. 12, at page 16, that in that case the assessee had desired to raise a question as to an assessment under Sec. 26, but the Income Tax Commissioner expressed the view that in the year after succession the depreciation was always calculated on the cost to the predecessor and he accordingly refused to raise a question on Sec. 26.

In the *Buckingham and Carnatic Company Case* the Privy Council were dealing with an assessment for the year 1931-32, although the business had originally been acquired by the assessee on the 4th December 1920. Four questions had been raised in that case by the Income Tax Commissioner, the first being whether the Buckingham and Carnatic Co., Ltd., which succeeded to the business of the five companies therein mentioned, is entitled under Sec. 10 (2) (vi) of the Act to depreciation allowance on the assets taken over from the five predecessor companies calculated on the original cost of those assets to such predecessor companies or on the value at which those assets were taken over by the Buckingham and Carnatic Co., Ltd., from the predecessor companies. The Privy Council answered that question in the sense in which the Bombay and Patna High Courts had answered it namely, that the depreciation was to be based on the value at which the assets were taken over by the purchasing company. The second question raised was in these terms: whether Buckingham and Carnatic Co., Ltd., is entitled to have the depreciation allowance from the years 1921-22 to 1930-31 recalculated on the basis of that decision, and to claim that the excess depreciation not allowed in those years should be allowed in its subsequent assessments or whether the claim for such excess depreciation lapses altogether. Their Lordships of the Privy Council considered that it was not necessary to express any opinion on that question, or on the other question raised, for those questions would have arisen only if the answer to the first question had been other than that

which the Privy Council gave to it. It is therefore clear that the Privy Council did not actually decide whether the assessment for the year 1921-22 was correct or not. It is however suggested that their Lordships indicated the view that the assessment for that year which had been based on the profits of the vendor companies, was correct. But it is to be noticed that the year 1921-22 was before the coming into operation of the Income Tax Act 1922, and the Income Tax Act of 1918 contained no section corresponding to Sec. 26 of the latter Act. It is moreover plain that an assessment ten years old could not have been reopened. It is no doubt true that the ratio decidendi in the Buckingham and Carnatic Company Case, as in the decisions of the High Courts which it approved, was that 'assessee' in Sec. 10 (2) (vi) means the successor and not the predecessor. I apprehend however that it would be open to their Lordships of the Privy Council to say that that view was limited to the case of an ordinary assessment on the profits of the assessee such as they were dealing with, and that they had not considered the question in relation to a hypothetical assessment on the profits of the previous year under Sec. 26 (2). If that course be open to the Privy Council, it must be open to this Court also, and in my opinion it would be wrong to hold that the decision of the Privy Council applies to a case which was not before the Board and was not adverted to in the opinion of the Board. In my opinion, therefore, it is open to this Court to consider on its merits the question whether in the case of a fictional assessment under 'Sec. 26 (2) 'assessee' in Sec. 10 (2) (vi) has the same meaning as it bears for the purpose of subsequent assessments, and means the person being assessed, or whether it means the person on whose profits the assessment is based and who was the owner of the premises on which depreciation is claimed during the year in which the profits were earned. For the reasons given above, I am of opinion that the latter view is right, and that the question raised by the Income Tax Commissioner should be answered in the negative.

PER BLACKWELL, J.—This is a reference by the Commissioner of Income Tax under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922, at the instance of a company, named the Mazagaon Dock Limited, of a question of law which has arisen out of the income tax and super tax assessments of the company for the financial year 1935-36 which ended on the 31st March 1936.

The Company has been, as from the 1st April 1936, carrying on business as shipbuilders and repairers. Before that the business

was carried on by a partnership firm known as the Mazagaon Dock. As the business of the partnership firm was taken over by the Company from the 1st April 1935, the Income Tax Officer assessed the company under Sec. 26 (2) of the Act for the financial year 1935-36 on the profits earned by the firm in the year which ended on the 31st March 1935, which was the "previous year" of the firm as defined in Sec. 2 (11) of the Act.

In arriving at the tax payable by an assessee in accordance with Sec. 10 of the Act under the head "business" in respect of the profits or gains of any business carried on by him, certain allowances are to be made, and among them an allowance is to be made on account of depreciation on buildings, machinery, plant or furniture as laid down in Sec. 10 (2) (vi) of the Act which reads as follows:

"(2) such profits or gains shall be computed after making the following allowances, namely—

(vi) In respect of depreciation of such buildings, machinery, plant or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed:—

Provided that:—

(a) the prescribed particulars have been duly furnished:

(b) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or, if there is no such allowance for that year, be deemed to be the allowance for that year and so on for succeeding years: and

(c) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Indian Income tax Act 1886, shall, in no case exceed the original cost to the assessee of the buildings, machinery, plant or furniture as the case may be."

The company claimed that Sec. 26 (2) of the Act required that the allowance should be computed on the original cost to the old firm and not to the company, and that all the unabsorbed depreciation due to the old firm under proviso (b) to Sec. 10 (2) (vi) of the Act should also be allowed. The Income tax Officer relying upon the judgment of the Privy Council in the case of *Commissioner of Income Tax, Madras v. The Buckingham and Carnatic*

Co., Ltd. [(1935) I.L.E. 59 Mad. 179] declined to accede to the contention of the company and computed the total depreciation allowable at Rs. 51,929, taking into account the original cost to the company itself and not the original cost to the old firm, and he assessed the company on an income of Rs. 2,36,986 under an assessment order dated the 2nd October 1936, Exhibit A. If the allowance had been computed on the original cost to the old firm and if the unabsorbed depreciation allowance had been added thereto, the total allowance for depreciation would have exceeded the total assessable income and the company would have been exempted.

The company appealed to the Assistant Commissioner of Income-tax by a petition dated the 27th November 1936, Exhibit B. The Assistant Commissioner heard the appeal and confirmed the assessment by his order dated the 4th January 1937, Exhibit C.

Thereupon the Company applied to the Commissioner requesting him to refer the matter to the Court under Sec. 66 (2) of the Act, and he has accordingly submitted with a statement of the case the following question of law :—

“ Whether in the circumstances of the case, the Income tax Officer has correctly computed the depreciation allowance under Sec. 10 (2) (vi) of the Act on the original cost to the assessee company itself, notwithstanding the fact that it was being assessed under Sec. 26 (2) of the Act as the successor to the partnership firm known as the Mazagaon Dock ”.

Mr. Coltman for the company contended that the case of *Commissioner of Income Tax, Madras v. Buckingham and Carnatic Co., Ltd.*, has no application to the facts of the present case. He said that in that case the assessment was for the year 1931-32, the Company having succeeded to the business some ten years before, and that it was not a case in which the company was being assessed upon the profits of the previous year as if it had been carrying on the business during the previous year and had received those profits. Mr. Coltman relied upon Sec. 26 (2) which is in the following terms :—

“ Where at the time of making an assessment under Sec. 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person the assessment shall be made on such person succeeding as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year ”.

He contended that this was a mere collecting section and that the profits of the old firm must first be ascertained before the assessment is made. He further contended that those profits could not be ascertained unless they were ascertained upon the same basis as they would have been ascertained if the former firm were being assessed. He drew attention to sub sec. (i), (ii) and (iii) of Sec. 10 (2) and argued that the company would be entitled to the benefit of all the allowances under those heads to which the old firm would have been entitled if the old firm were being assessed. He submitted that notwithstanding that the depreciation allowed by sub-sec. (vi) of Sec. 10 (2) of the Act is a depreciation of buildings, machinery, plant or furniture which are the property of the assessee and that that allowance is to be a sum equivalent to such percentage on the original cost thereof to the assessee, the company was nevertheless entitled to depreciation on the original cost to the old firm and not to the company. He said that Sec. 26 (2) as it now stands only came into existence by virtue of the Indian Income tax (Amendment) Act, 1928, (III of 1928) that no reference was made to this section in the Privy Council case, and that the Privy Council decision in that case has no bearing upon the question now before this Court.

I do not agree with Mr. Coltman's contentions. When the Buckingham and Carnatic Co., Ltd., was assessed in 1921-22, the Indian Income Tax Act of 1918 was then in force. That Act contained no section similar to Sec. 26 which was introduced into the Act of 1922, or to Sec. 26 which is now in force. But, as was pointed out in the course of the judgment of their Lordships, in 1921-22 the year subsequent to the amalgamation, the Company was in fact assessed upon the entire profits of the five companies as having succeeded to their business, and during the assessment the Company claimed to deduct depreciation on the buildings and machinery calculated on the original cost thereof to the five companies, but this claim was disallowed, and depreciation calculated on the written down cost, namely, the actual cost to the Company only was allowed. Although their Lordships were dealing with the assessment for the year 1931-32, Mr. Hills in the course of his argument for the company is reported to have said:—

“Here the successor who is taxed is carrying on, continuing, the same business. It is fair that he should be taxed as his predecessor would have been if he had continued the business. Normally “Assessee” means assessee for the taxing year, “but original cost

to the assessee ' might mean to the assessee from whom the purchase was made ".

This is an argument similar to that of Mr. Coltman based upon Sec. 26 (2), and although the question of the correctness of the assessment for 1921-22 was not directly before their Lordships, the argument of Mr. Hills certainly raised that question and there is not a word in their Lordships' judgment which suggests that their Lordships thought that the claim was in that year wrongly disallowed, or that a different meaning should be given to the words used in Sec. 10 (2) (iv) if the question arises in the year immediately after the succession to the business from the meaning which should be given to them if the question arises either in the next year after that or ten years later.

In the present case the language of Sec. 26 (2) appears to me to be against the Company rather than in its favour. Under that section the Company is to be assessed as if ~~it~~ had been carrying on the business throughout the previous year, and as if ~~it~~ had received the whole of the profits for that year. It is an artificial assessment upon the Company as if it, and not the firm, had been carrying on the business during the previous year. It has been argued that the Company did not exist in the previous year, that it was not the owner of the buildings, machinery and plant in that year, and that consequently in ascertaining the profits of the firm for the previous year depreciation must be calculated with reference to the original cost to the firm. This argument appears to me to be fallacious. The question as to what allowance is to be made for depreciation arises when the return is made. Under Sec. 3 of the Act income tax is to be charged for the year at the rate applicable to the total income of the assessee for that year in respect of the profits of the previous year. The return of income which the company was required by Sec. 22 to furnish was a return of its own income during the previous year, and although the company did not exist during the previous year, it is to be deemed by Sec. 26 (2) to have existed and to have been carrying on the business. Consequently the Company must be treated as having made a return of its own profits during the previous year, and as having been the owner of the buildings, machinery and plant during the previous year. Apart from this the question of allowance for depreciation does not arise until the return of income is made, and when the return was made the company was the owner of the buildings, machinery and plant and the original cost thereof to the Company had been ascertained and determined. Seeing that the assessment

is an artificial assessment upon the company as if it, and not the firm, had been carrying on the business, during the previous year, quite apart from the words of Sec. 10 (2) (vi), which in my opinion are too plain to be got rid of, it seems to me impossible to hold that the word "assessee" in Sec. 10 (2) (vi) can be taken to refer to the firm.

In the Privy Council case their Lordships in their judgment observed that the learned Judges of the High Court of Madras expressed the opinion that the Legislature in Sec. 10 (2) (vi) was not envisaging any case of a successor company, and that what was in mind was the original company. That opinion did not commend itself to their Lordships of the Privy Council. The argument for the company in the present case appears to me to involve the supposition that the Legislature intended that Sec. 10 (2) (vi) when it was first enacted should have one meaning in the case of an original assessee being taxed and another meaning in the case of a successor being taxed on the profits for the previous year as if it had been carrying on the business during the previous year if the Act were subsequently amended in that behalf. I cannot suppose that the Legislature had any such intention. Certainly if that had been the intention when Sec. 26 was introduced it would have been perfectly simple to employ appropriate language in reference to Sec. 10 (2) (vi) to say so. It may be that it would be just to amend the Act to meet a case like the present, but that is a matter for the Legislature, and upon the plea that justice requires it I do not feel myself at liberty to place upon Sec. 10 (2) (vi) a strained artificial meaning in the first year after a succession, while giving to it, as I am bound to do by the ordinary canons of construction and upon authority, its plain and natural meaning in the years following.

It is said that difficulties will arise in giving effect to Sec. 10 (2) (i), (ii) and (iii) in the case of a successor to a business. But the fact that difficulties may arise in reference to the other allowances contemplated by Sec. 10 (2) cannot in my opinion outweigh the plain meaning of the words used in Sec. 10 (2) (vi).

In the Privy Council case their Lordships emphasized three points:—(1) There is no ambiguity in the provisions of Sec. 10 (2) (vi), and the ordinary and natural meaning of the words must be taken; (2) the word "assessee" is used in the sub-section in two places, first, with regard to the ownership of the property, and secondly, with regard to the original cost thereof, and in the ordinary and natural meaning of the sub-section, the word

"assessee" so used must refer to the same person, namely, the person who owns the property, while the depreciation is to be based on the original cost of such property to such person; and (3) if there were any doubt about the interpretation, it would be removed by reference to the definition of "assessee" contained in Sec. 2 (2) of the Act, namely, the person by whom income tax is payable.

The reasoning of their Lordships in the Privy Council case appears to me plainly to be applicable to the facts of the present case, and Sec. 26 (2) of the Act makes no difference in my opinion to its applicability. Applying that reasoning, and construing the words used in Sec. 10 (2) (vi), read with the definition of "assessee" in Sec. 2 (2), in their ordinary and natural meaning, I am of opinion that the question submitted should be answered in the affirmative. I answer it accordingly.

PER RANGNEKAR, J.—This is a Reference made by the Commissioner of Income Tax, Bombay, under Sec. 66 (2) of Act XI of 1922. The facts are simple and not in dispute. It appears that there was a firm called the Mazagaon Dock, carrying on business in Bombay as shipbuilders and repairers up to 31st March 1935. On the 1st of April 1935, the firm was converted into a limited company and its business was taken over by the limited company, known as the Mazagaon Dock, Limited. Under Sec. 26 (2) of the Act, the Company was assessed by the Income Tax Officer, Companies' Circle, for the tax year beginning on the 1st of April 1935, on the profits earned by the firm for the year ended 31st March 1935, which was the previous year of the firm as defined in Sec. 2 (11) of the Act.

In computing the income of the Company, under the head "business" an allowance on account of depreciation of building, machinery, plant or furniture is to be made at the prescribed rates as laid down in Sec. 10 (2) (vi) of the Act. The Company claimed that the allowance should be computed on the original cost of the building, machinery, plant, etc., to the firm, and not on the cost paid by the Company which succeeded to the business of the firm. The Company further claimed, that in addition, all the unabsorbed depreciation due to the firm under Proviso (b) to Sec. 10 (2) (vi) of the Act should be allowed. The Income Tax Officer relying on the Privy Council decision in *The Commissioner of Income Tax, Madras v. Buckingham and Carnatic Co. Ltd.*, (1935 I.L.R. 59 Mad. 175), rejected the claim and computed the total depreciation allowance by the reference to the cost of the building, machinery etc., paid by the Company to the firm. The Company

appealed to the Assistant Commissioner of Income Tax, who however, confirmed the assessment made by the Income Tax Officer.

If the claim made by the Company had been allowed, the total allowance for depreciation would have exceeded the total assessable income of the company, and, as the Commissioner points out, the Company would have been exempted. That is the importance of the question.

The Company, then, appealed to the Commissioner of Income Tax, and he has referred the question of law arising on the facts of the case, which is set out in paragraph 6 in these words :

"Whether in the circumstances of the case, the Income Tax Officer has correctly computed the depreciation allowance under Sec. 10 (2) (vi) of the Act on the original cost to the assessee Company itself, notwithstanding the fact that it was being assessed under Sec. 26 (2) of the Act as the successor to the partnership firm known as the Mazagaon Dock."

The Commissioner is of opinion that the question should be answered against the Company. The question thus raised turns upon a true construction of Sec. 2 (2) read with Sec. 10 and Sec. 26 (2). Section 26 (2) was re-cast by the Income Tax (Amendment) Act of 1928, being Act III of 1928. The section, so far as material, is in the words following :—

"Where at the time of making an assessment under Sec. 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year."

It is plain, therefore, that the assessment to be made under this section is a hypothetical assessment, and the successor to a business is to be assessed, and he becomes liable to pay tax, not on his income—in this case, admittedly he had none—but on the income of his predecessor for the previous year. How is that income to be ascertained? For that we must turn to Sec. 10. That section provides that the profits or gains of any business shall be computed after making certain allowances mentioned in the section. The only allowance which need be considered in this case is that allowed by Section 10 (2) (vi), which is in these words :—

"(vi) In respect of depreciation of such building, machinery, plant or furniture being the property of the assessee, as may, in any case or class of cases, be prescribed ;

Provided that—

(a) the prescribed particulars have been duly furnished;

(b) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable being less than the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or if there is no such allowance, for that year, be deemed to be the allowance for that year, and so on for succeeding years; and

(c) the aggregate of all such allowances made under the Act or any Act repealed hereby, or under the Indian Income Tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant or furniture, as the case may be."

So far then the position seems to be simple. A successor to a business is to be assessed not on his own income but on the income made by his predecessor and that income can only be ascertained after making certain deductions sanctioned by Sec. 10 (2) (vi). The dispute between the parties is as to the manner in which the allowance in respect of depreciation of the buildings, machinery etc., is to be calculated. It is argued on behalf of the Commissioner of Income Tax that in calculating the allowance regard must be had to the actual price paid by the Company to the firm when the former acquired the business in question from the latter. The Advocate-General says the words "original cost" of the buildings, etc., "to the assessee" in Sec. 10 (2) (vi) must refer to the company as it is the "assessee" in question as defined by Sec. 2 (2). On the other hand, the argument on behalf of the Company is that in the circumstances of the case the word "assessee" can only refer to the firm and the allowance must be calculated on the basis of the original cost of the building, etc., to the firm. In my opinion, it is difficult to accept the contention raised on behalf of the Commissioner of Income Tax.

Sec. 2 (2) no doubt defines an "assessee" as a person by whom income tax is payable. But the section itself provides that the word "assessee" is to be understood in this sense unless "there is anything repugnant in the subject or context", and that, in my opinion, is the case here. It is only after a person's income is ascertained or assessed under Sec. 23 that that person becomes an "assessee". The liability to tax can only be determined after a person's income is computed, and it seems to me doubtful that the term "assessee" is always used in the strict sense of the

definition throughout the Act. Apart from this, to hold that the Company in this case is the "assessee" within the meaning of Sec. 10 would give rise to considerable difficulty.

As stated above, Sec. 10 provides that before computing the profits or gains of a business certain deductions are to be made in favour of the owner of the business whose profits or gains are being assessed under Sec. 23. If a question as to the method of calculating all the allowances other than the depreciation allowance in respect of building, etc., had arisen in this case, then it is clear that in doing so, the position of the firm would have had to be taken into consideration. I shall refer to these allowances to make my meaning clear.

The first allowance under Sec. 10 relates to—

"any rent paid for the premises in which such business is carried on, provided that when any substantial part of the premises is used as a dwelling house by the assessee the allowance under this clause shall be such sum as the Income Tax Officer may determine having regard to the proportional part so used."

Under Sec. 10 (3) the word "paid" means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section. Now, what is the rent which will have to be considered and who paid the rent in the previous year? Surely, it would be rent actually paid by the predecessor; the successor has admittedly paid no rent in the year in question. Similarly, if part of the premises were used as a dwelling-house, the allowance is to be calculated in a particular manner. If part of the premises is used by the predecessor during the previous year, then it is difficult to see how the word "assessee" could be used with reference to the successor. The next clause refers to repairs :

"(ii) in respect of repairs, when the assessee is the tenant only of the premises, and has undertaken to bear the cost of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed."

If any allowance is claimed for repairs, it can only be granted on the basis of the cost of the repairs to the predecessor of the Company in the previous year, the Company not being in existence in that year. The third allowance is for capital, and that can only refer to the capital borrowed by the predecessor for the purpose of business. Then there is an allowance for current repairs to the building. That can only apply to repairs in the

previous year 1934-35, which could only have been done by the predecessor and not by the successor. Similarly, in the clause under consideration now, the building, etc., could only be the property of the predecessor in the previous year, and it can hardly be said that it was the property of the successor Company in that year. Then, let us look at Section 10 (2) (vii). The allowance there sanctioned is in respect of any machinery or plant which in consequence of its having become obsolete has been sold or discarded, and it is to be calculated on the difference between the original cost to the assessee of the machinery or plant as reduced by the aggregate of the allowance made in respect of depreciation under clause (vi). If a question as to this allowance had arisen in this case, how would the allowance have been calculated? It could only have been calculated on the original cost to the firm in respect of the machinery sold. If then the word "assessee" in this clause means the "firm", it is difficult to see why in clause (vi) it should mean the "Company". Then again, in the next clause (vii) (a) referring to animals used for the business which have died, the same consideration would apply. Clause (viii) refers to the allowance in respect of land revenue, local rates and municipal taxes paid in respect of the premises used for the purposes of the business. How can this apply to the Company in this case?

As I have said, the assessment is hypothetical. It is the income of the predecessor that has to be assessed, and that income cannot be ascertained except by making certain deductions. To accept the argument submitted on behalf of the Commissioner of Income tax would result in the adoption of a fictitious method of ascertaining the true income of the predecessor. That is to say, in ascertaining the income for the year 1934-35 of the predecessor, you have to take into account the allowance calculated not on the original cost to him but on the original cost to somebody else. How can it then be said that the income arrived at in this fictitious manner represents the true taxable income of the predecessor? Is there anything which compels us to say that? I think not. Otherwise, the result is this, that not only the assessment is hypothetical, but the method of calculating the income of the predecessor must also be hypothetical. But the Legislature has not said so. In my opinion, where that is the position, the Court ought to adopt the construction which is most favourable to the subject.

The difficulties that I have pointed out are not denied by the Advocate General. But he says that under Sec. 26 (2), the assessee

is the successor and he must be treated as if he was carrying on business in the previous year, and he relies in support of this argument on the Privy Council decision in the case of the *Commissioner of Income Tax, Madras v. The Buckingham and Carnatic Co. Ltd.* He submits that the point which is now raised is covered by the decision of their Lordships in that case. In my opinion, there is nothing in that case which is applicable to the facts of this case. The case arose under the Act of 1922, and in that case, their Lordships were not considering a hypothetical assessment under Sec. 26 (2). Sec. 26 (2) was not even referred to. Their Lordships were dealing with the case of an ordinary assessment of income earned by the assessee himself, and that was the only question. In such a case, it is perfectly plain that in calculating the income actually earned by the successor of a business, he would be entitled to a deduction on the basis of the actual cost of the machinery, etc., paid by him to his predecessor. No difficulty such as I have pointed out above on the language of Sec. 10 can arise in such a case. That is the view we took in the case of the *Commissioner of Income tax, Bombay Presidency v. The Saraspur Mills Co., Ahmedabad*, [1931, I.L.R. 56 Bom. 129]. But here, the position is quite different. This is not a case of an ordinary assessment of income actually made by the successor. The point with which I have to deal in this case was included in the second question raised in the Privy Council case, but their Lordships did not consider it necessary to express any opinion on the question. I am therefore unable to hold that the question raised here is covered by that decision. Upon the whole, therefore, I have reached the conclusion that in this case where we are only concerned with a hypothetical assessment in the very first year of a successor taking over a business from his predecessor, apart from the fact that the words "original cost" would be inappropriate, it would be difficult to hold that depreciation should be allowed on the original cost to the successor and not on the original cost to the predecessor.

I would answer the question submitted in the negative.

Question answered in the negative.

[IN THE RANGOON HIGH COURT].

THE KOKINE DAIRY

(By one of the partners J. Vertannes)

v.

COMMISSIONER OF INCOME TAX, BURMA.

MYA BU and SHARPE, JJ.

November 30, 1937.

AGRICULTURAL INCOME—DAIRY BUSINESS—QUESTION WHETHER INCOME FROM DAIRY BUSINESS IS AGRICULTURAL INCOME—QUESTION OF LAW—REFERENCE—INDIAN INCOME TAX ACT (XI of 1922), SECS. 2 (1), 4 (3) (VIII), 66.

Where the petitioners who carried on a dairy business under the name Kokine Dairy were assessed on their income derived from this business and an application made by them to the Commissioner to refer to the High Court the question 'whether in the circumstances of the petitioners' case the income from the Kokine Dairy was not agricultural income within the meaning of Sec. 2 (1) of the Act and as such exempt from taxation under Sec. 4 (3) (viii) of the Act' was rejected by the Commissioner on the ground that it was a question of fact, the High Court held that the question whether the income derived from the business in question was agricultural income or not was not a question of fact but a question of law and directed the Commissioner to state the case.

It is always open to an assessee who desires to argue the legal consequences of the facts to require a reference as to whether the Commissioner has attributed in law the correct legal consequences of the facts he has found.

COMMISSIONER OF INCOME TAX, MADRAS v. MANSOOKHLAL ZAVERI [1937] (I.L.R. 1937 Rang. 26 ; 1937 I.T.R. 664) followed.

Civil Miscellaneous Application No. 75 of 1937.

Application for a mandamus made under Sec. 66 (3) of the Income-tax Act, requiring the Commissioner of Income-tax to state a case and refer it to the High Court on the following question of law :—

"Whether in the circumstances of petitioner's case, the income from the Kokine Dairy is not agricultural income within the

meaning of Sec. 2 (1) of the Act and as such exempt from taxation under Sec. 4 (3) (viii) of the Act."

Mr. Kalyanwalla, for the assessee.

JUDGMENT.

MYA BU, J.—The petitioners are an unregistered firm who were assessed for the year 1936-37 upon income derived from their dairy business. They objected to the assessment *inter alia* upon the ground that the income derived from such business is agricultural income within the meaning of Sec. 2 (1) (b) of the Income tax Act. On appeal the Assistant Commissioner of Income tax held that in the circumstances of the case the income was not agricultural income. The petitioners thereupon applied to the Commissioner of Income tax under Sec. 66 (2) for a reference to the High Court upon a question of law, namely, whether in the circumstances of the case the income derived from the business was agricultural income or not. The Commissioner of Income tax, by his order dated the 2nd June 1937, dismissed the petitioner's application on the ground that there was no question of law involved in the case which, according to him, turned not on law but only on facts.

In a Full Bench case of this Court, *Commissioner of Income-tax, Burma v. S. Mansooklal* it is laid down that—

"It is therefore always open to an assessee who desires to argue the legal consequences of the fact to require a reference as to whether the Commissioner has attributed in law the correct legal consequences of the facts he has found."

In the judgment of LMAOH, J., it is observed :—

"In order to answer the question, it is, of course necessary to ascertain the facts; but, having ascertained them, it is then necessary to consider whether they constitute succession within the meaning of the section. Primarily, the question is one of fact, and the facts may be such that the case presents no difficulty; but the proper legal effect of a proved fact is essentially a question of law, as their Lordships of the Privy Council pointed out in *Nafar Chandra Pal v. Shukur* (1918, 45 I.A. 183) and *Dhanna Mal v. Moti Sagar* (1927, 54 I.A. 171)."

In view of these pronouncements, we are not satisfied that the Commissioner of Income tax is right in holding that there is no question of law involved in the case.

We, therefore, require the Commissioner to state and refer the case upon the question as to whether the income derived from the business in question was agricultural income or not.

SHARPE, J.—The point in this case is a very short one. We are not concerned with the final result of the proceedings as to whether or not the assessee has been correctly assessed. We are only concerned with the procedure at this stage.

The Commissioner of Income tax was required by the assessee under Sec. 66, Sub-sec. 2, of the Act to refer to this Court the present case involving, as the assessee said, a question of law. The Commissioner was duly required to make this reference by the assessee but he refused. He said there is no question of law, it is a question of fact. So the assessee has come to us under Sec. 66, sub-sec. 3, and asked us to say that the Commissioner's decision that there was no point of law was wrong.

Questions of fact and law are very difficult to disentangle as was pointed out by Lord Buckmaster in *Nafar Chandra Pal v. Shukur* where, at page 187, he said: "The proper legal effect of a proved fact is essentially a question of law." And in a decision of seven judges of this Court in *The Commissioner of Income tax, Burma v. S. Mansooklal*, the learned Chief Justice, after referring to the material parts of Sub-secs. (2) and (3) of Sec. 66, said :—

"It is therefore always open to an assessee who desires to argue the legal consequences of the facts to require a reference as to whether the Commissioner has attributed in law the correct legal consequence of the facts he has found."

I am, therefore, not satisfied with the correctness of the Commissioner's decision that this is a question of pure fact and not of law and therefore I agree with my learned brother that the Commissioner must now be required to draw up a statement of the case and refer it, with his opinion thereon, to this Court.

Of course I express no opinion as to the ultimate result of this case.

I only desire to add that I think it is extremely unfortunate that the Commissioner of Income-tax has not seen fit to come before this Court by instructing the Advocate-General, who is always too willing to give every assistance possible to this Court whenever he is instructed. Cases are seldom as simple and clear as is often imagined.

[IN THE BOMBAY HIGH COURT].

SIR CHINNUBHAI MADHOWLAL

v.

COMMISSIONER OF INCOME TAX, BOMBAY.

SIR JOHN BEAUMONT, C. J., and BLACKWELL, J.

March 23, 1937.

REFERENCE—COSTS—COSTS OF SETTLING APPLICATION FOR
REFERENCE—WHETHER ALLOWABLE—DISCRETION OF TAXING
MASTER—INDIAN INCOME TAX ACT (XI of 1922) Sec. 66 (6).

It is the application of the assessee to the Commissioner to state a case and make a reference to the High Court which starts the proceedings which ultimately result in the reference and the High Court has therefore power to deal with all the costs of and subsequent to the application, and in a proper case the Taxing Master is entitled to allow to the assessee if he has been given the costs, the costs of obtaining proper advice in settling the application; and where the costs are given to the Commissioner the Taxing Master is entitled to allow the Commissioner the costs of getting the reference settled by the Government solicitor and the Counsel for the Commissioner of Income Tax. It is however entirely in the discretion of the Taxing Master to decide whether the case is of sufficient difficulty to justify the Commissioner in adopting this course.

Application.

The Commissioner of Income-tax, Bombay, had made a reference to the High Court under Sec. 60 (2) of the Indian Income-tax Act, XI of 1922, the question referred being as follows: "Whether under any provision of the Indian Income-tax Act, XI of 1922, the loss of Rs. 8,58,73 suffered by the assessee on account of money invested in debentures issued by the Agra Spinning and Weaving Co., Ltd., and lost when that Company was wound up, can for the purpose of Sec. 24 (1) of the Act be treated as "a loss of profit or gains" under any of the heads of income in Sec. 6 of the Act and set off against the income of the assessee under any other head, for the purpose of assessment for the financial year 1933-34." The reference was heard by a Division Bench consisting BEAUMONT, C.J., and RANGNEKAR, J., and their Lordships answered the question in the negative, and ordered "costs to be paid by the assessee on the Original Side scale." (*Vide* 1937 I. T. R. 210).

At the time of taxing of costs, the Assistant Taxing Master allowed a sum of Rs. 110 as costs incurred by the Commissioner in drawing up the reference by the Government Solicitor and in having it settled by the Advocate General, observing as follows :

"It is the present practice of the Taxing Office to allow these costs as being necessary for the proper attainment of justice. I intend following the practice. If such costs are not allowed it might result in considerable waste of judicial time. While appreciating the argument of counsel for the assessee and bearing in mind also the provision of Sec. 66 (4) of the Act which provides for reference back to the Commissioner I consider these antecedent costs as necessary for attainment of justice ".

The assessee thereupon made an application to the Court contending that the amount of Rs. 110 should be excluded from the taxed amount of costs of the Commissioner of the reference, and, in the alternative that the fee of Rs. 100 already deposited with the Commissioner at the time of applying for a reference under Sec. 66 (2) should be set off against the costs claimed by the Commissioner for drawing up the statement of the case and the opinion thereon of the Advocate General.

K. S. Shavakshyah with *Messrs, Mulla & Mulla*, for the applicant-assessee.

The Advocate General with the *Government Solicitor*, for the Commissioner of Income-tax.

SIR JOHN BRAUMONT, C. J.—This is an application to review the Assistant Taxing Master's order in relation to the costs of Civil Reference No. 11 of 1935, (reported in 1937, 5 I. T. R. 210) which was a reference to this Court made by the Commissioner of Income-tax under Section 66 (2) of the Indian Income-tax Act.

The order made on the reference was that the assessee should pay the costs of the Commissioner on the Original Side scale. In taxing the costs, the Assistant Taxing Master has allowed a fee for getting the reference settled by the Government Solicitor and the Advocate General ; and the question is whether he had any power to make such an allowance.

The argument of Mr. Shavakshah for the applicant (assessee) is that under Sec. 66 (2) the assessee is entitled on payment of Rs. 100, referred to in that section, to require the Commissioner to refer a point of law to the High Court, and that, no doubt, is so. Mr. Shavakshah contends from that, that the fee of Rs. 100

is intended to cover the costs of the Commissioner in relation to the preparation of the reference. The jurisdiction of the Court to deal with costs is conferred by sub-Sec. (6) of Sec. 66, which is in these terms :

“Where a Reference is made to the High Court on the application of an assessee, the costs shall be in the discretion of the Court.” That sub-section, therefore, merely deals with costs of a reference made on the application of an assessee, and not with costs of a reference made by the Commissioner on his own motion under sub-Sec. (1) of Sec. 66. The question is what costs has the Court discretion to deal with under sub-Sec. (6) of Sec. 66.

It seems to me that it is the application of the assessee to the Commissioner to state a case and make a reference to the High Court which starts the proceedings which ultimately result in the reference, and in my opinion, the Court can deal with all the costs of, and subsequent to, the application. In a proper case, the Taxing Master is entitled to allow to the assessee, if he has been given his costs, the costs of obtaining proper advice in settling the application; and where costs are given, as in this case, to the Commissioner, in my opinion, the Taxing Master is entitled to allow the Commissioner the costs of getting the reference settled by the Government Solicitor and the Advocate General. It is entirely in the discretion of the Taxing Master to decide whether the case is of sufficient difficulty to justify the Commissioner in adopting the course. If the Taxing Master thinks that it is a simple case, he probably will not allow the fees for settling it. But most of these cases are not very simple, and it is of importance that they should be settled with accuracy by somebody acquainted with the art of draftsmanship.

It is said that in effect the assessee is really paying more than Rs. 100, which he is required to pay by the section for getting a reference to the High Court, if he has also to pay the costs for getting the reference settled. But that is a matter in the discretion of the Court. In many cases where this Court gives costs to the Commissioner, we direct the costs should be “less Rs. 100”, if we think that in the particular case the Rs. 100 deposit ought to be taken into account. In the present case, I rather gather from the judgment, that we thought that the reference never had any chance of success, and, therefore, we did not make any allowance for the 100 rupees. But whether the assessee ought to pay the costs, plus Rs. 100 is a matter which can always be adjusted by the Court when it is dealing with costs,

I think that the decision of the Assistant Taxing Master was right, and the application must be dismissed with costs, which should be taxed on the Original Side scale.

BLACKWELL, J.—I agree, and have nothing to add.

Application dismissed.

[IN THE PATNA HIGH COURT].

MULCHAND HIRALAL

v.

COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA.

SIR COURTNEY-TERRELL, C.J., and AGARWALA, J.

November 30, 1937.

ALLOWANCES—THEFT FROM SERVANT TAKING MONEY TO BANK—WHETHER ALLOWABLE—BUSINESS EXPENDITURE—CAPITAL LOSS—WRONGFUL INCLUSION OF ITEM IN PROFITS—REMEDY OF ASSESSEE—CLAIM FOR DEDUCTION IN SUBSEQUENT YEAR—PERMISSIBILITY—INDIAN INCOME TAX ACT (XI OF 1922), Sec. 10 (2) (ix).

If an assessee has wrongly included an amount as profits for a year and paid income tax on it, he cannot on discovering the mistake claim a deduction of an equal amount from the profits of a subsequent year. His proper remedy is to apply to the Commissioner to revise the wrong assessment and to get a refund.

The assessee sent a sum of money through one of his employees to a bank and on the way it was stolen by a coolie from the employee; Held, that the assessee was not entitled to have this amount deducted from his profits for purposes of assessment to income tax.

Per COURTNEY-TERRELL, C.J.—A loss whether by embezzlement or whether by theft is not one of the allowances which is available to the assessee under Sec. 10 of the Act.

JAGANNATH THERANI v. COMMISSIONER OF INCOME TAX, BIHAR AND ORISSA (I.L.R. 4 Pat. 385) *dissented from.*

RAMASWAMI CHETTIYAR, S.P.S. v. COMMISSIONER OF INCOME TAX, MADRAS (I.L.R. 53 Mad. 904) *Referred to.*

Miscellaneous Judicial Case No. 10 of 1935.

The Statement of Case made by the Commissioner was as follows :—

“ Statement of Case in Mulchand Hiralal of Bhadrak, for the assessment year 1933-34, *viz.*,

(1) “ Whether the disallowance of the claim for deductions of two sums, namely, Rs. 313 and Rs. 700 is legal ;

(2) “ Whether in the circumstances the sum of Rs. 2,365 should be lawfully deducted from the assessee's return ”.

I have the honour to submit the following statement :—

Before stating this case, I may be permitted to state that I did not receive any notice of the application under Section 66 (3) of the Income Tax Act by the assessee which was apparently moved by the assessee's legal representative in the Circuit Court, Cuttack. The invariable practice of the Patna High Court of serving a notice on the Income-tax Department and hearing their advocate before granting an application under Section 66 (3) of the Income-tax Act has not been followed in this case. If this had been done and the facts relating to the above questions could be placed before the Hon'ble Judges at the preliminary stage, it is respectfully submitted, probably no statement of case would have been called for.

Facts relating to the 1st question :—

The assessment in this case has been made on the income of the assessee's accounting period 1987-88 Samvat. The assessee alleges that in the accounts of the period 1986-87 he had, by mistake, credited a sum of Rs. 313 to a goods account instead of to a personal account and this showed for that year a higher profit than what he had actually derived. Similarly in the same year or years prior to the accounting period for the 1933-34 assessment, the assessee had made incorrect entries resulting in his showing a profit of Rs. 700 more than what he had earned. He professed to have discovered these mistakes later and claimed to deduct these sums in the computation of the profit of the accounting period (1987-88) assessed in 1933-34 in this case, and this claim was disallowed by the Income-tax authorities. A copy of the Income-tax Officer's assessment order is enclosed (annexure A) not (reported). The Assistant Commissioner in his appellate order (copy enclosed as Annexure B) confirmed the Income-tax Officer's Order. The assessee then moved the Commissioner of Income-tax under Sections 33 and 66 (2) of the Income-tax Act but was unsuccessful (copy of Commissioner's order enclosed as Annexure C) (not reported).

This is not a case of an unadjusted account of a previous year finally adjusted in the year under consideration. The assessee seeks, by an indirect way, to revise an alleged wrong assessment of a previous year by setting off the alleged excessive profit taken in an assessment in a previous year against the actual profits of the year under consideration.

Opinion of the Commissioner :—If the assessee had been unjustly assessed on these sums in preceding years, he had his remedies under Sections 30 and 33 and other sections of the Income Tax Act. He cannot claim deduction for the alleged excessive assessment of a previous year from the profits of a subsequent year. If this were allowed, there would be no finality in the assessment of any year.

These deductions are claimed against the profits from business. The allowances to be made for computing the profits or gains under this head are set forth in Section 10 of the Income Tax Act. Such a deduction as is claimed by the assessee is not included in that section.

The answer to the first question is therefore in the affirmative.

Facts relating to the 2nd question : The facts relating to the 2nd question are as follows :

On 29-12-30 the assessee sent Rs. 2,960 from Bhadrak to his Calcutta Branch. The employee subsequently reported to his master that the sum was stolen by a cooly whom he engaged at the Howrah station. The assessee prosecuted his employee for embezzlement, but the Criminal Court held that there was no embezzlement and discharged the employee on 26-3-31. The assessee claimed deduction for this loss against the profits earned by him during the year ending March 1933.

Opinion of the Commissioner :—The loss is not allowable on two grounds, *viz.*, (1) the loss did not occur in the year of accounting and (2) it was not a case of embezzlement by an employee but of theft by an outsider. The cash lost was not the stock in trade of the assessee's business nor was it an expenditure necessary for carrying on the business or in earning the receipts, and as such it was capital loss. In this view I am fortified by the decision of the Lahore High Court in *L. N. Gadodia & Company Case*, VII I.T.C. 393.

It is requested that a copy of the order of the High Court in this case may be forwarded to me under Section 66 (5) of the Act.

Mrs. Dharmashila Lall and *Mr. G. C. Das*, for the Assessee.

Mr. S. M. Gupta, for the Commissioner of Income-tax.

JUDGMENT.

COURTNEY-TERRELL, C. J.—This is a case stated by the Commissioner of Income-tax by direction of the Court. The assessee carries on business as a shopkeeper where he sells retail groceries and he also carries on business by selling goods on commission, the two businesses, being in fact separate. He has made, however, a return of his entire income, and he claims allowance in respect of two separate items. The first item is composed of two separate sums respectively Rs. 313 and Rs. 700, and the assessee claims to be entitled to deduct the amount of these two items from his assessment in the following circumstances. In the accounting year 1931-32 it would appear that in making up his accounts he confused the accounts in respect of the shop business with the accounts in respect of the commission business in the matter of two items. Certain goods had been sent to him to be sold on commission but the accounts, in respect of two of the parcels of goods sent to him for sale on commission were as a matter of fact entered as having been made in respect of the shop business, and he put down in the accounts the two items of goods Rs. 313 and Rs. 700 as being goods purchased by him, and in making up the accounts for that year these were taken upon the assets side of the account and figured in the profit for the year. They should have gone into that account which dealt with the commission business, in which case they would not have been put down as coming into the business as assets at all. The result was that for the year 1931-32, if the statement of facts be correct, he had to pay income-tax, on a sum which had been arrived at by accounting these two items as receipt, and so he paid income-tax on a sum of Rs. 312 and Rs. 700 which he need not have paid if he had made up his books correctly. After the closing of the account for 1931-32 and the payment of income-tax, he discovered his mistake and now seeks to deduct those sums in the present account for 1932-33, and the ground upon which he claims to be entitled to deduct them is that if he paid tax on them he would be paying tax twice over. This argument is not tenable. On a proper application to the Commissioner of Income-tax, the Commissioner of Income-tax would be entitled to find that in respect of the year 1931-32 the assessee had paid more tax than what he should have paid, and in making up the account for 1932-33 (which is the year under consideration) he need not

include these sums at all; but he cannot do it both ways. His proper remedy should have been to go to the Commissioner in the matter of the accounting year 1931-32, show the satisfaction of the Commissioner that in respect of that year he had made a mistake in making up his accounts and get a refund of the income tax in respect of the assessment for 1932-33. The Commissioner was right in our opinion in his finding, and to the question "whether the disallowance of the claim for deductions of two sums, namely Rs. 318 and Rs. 700 is legal" I would answer it, in agreement with the Commissioner, in the affirmative.

The second item in respect of which the assessee claims a deduction from the amount upon which he is to be assessed is in respect of some money that appears to have been stolen from him. In the accounting year 1931-32 he was sending some of his money to the bank and sent it by a messenger in his employ. The money disappeared, and the assessee seems to have been under the impression that the employee had embezzled the money, with the result that there was a criminal trial. The Criminal Court held that the money had not been in fact embezzled by the employee but had been stolen from him by a coolie. In my opinion, the decision of the Commissioner that the loss did not occur in the year of accounting (1932-33) is one on the facts which is fatal to the contention of the assessee. But quite apart from this, a loss, in my opinion, whether by embezzlement or whether by theft is not one of the allowances which is available to the assessee under Section 10 of the Act. It is true that there is a decision of this Court in *Jagarnath Therani v. Commissioner of Income tax* (I.L.R. 4 Patna, 385) in which the facts were that the loss was produced by embezzlement, and the learned judges there held, and I am at some difficulty to understand the reasoning upon which the decision was based, that the loss was incidental to the conduct of the business and allowance should be made on that basis. In my opinion the decision in that case was erroneous but the whole decision was based upon the fact that the loss in that case was by embezzlement and it can be distinguished from this case very clearly, because in this case the loss was by theft, and not by embezzlement. The test of whether a claimed allowance is or is not allowable is to be found by referring to the Act itself, and Sec. 10 sets forth a list of permissible allowances. They are specified in sub-sec. (2). Paragraphs (i) to (viii) of that sub-section admittedly do not apply and this particular loss cannot be classified under any of the items in that particular sub-section. Paragraph (ix) is as follows; "any expenditure (not being

in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains". Now, I have failed altogether to understand how a theft can be considered as expenditure, and in any case the reference to the "expenditure incurred solely for the purpose of" must refer to the mind of the person who is claiming allowance. It cannot refer to the mind of the thief. When money is stolen, the person from whom such money is stolen is parting with the money unwillingly or unknowingly and he cannot be said to lose the money for the purpose of earning such profits or gains. A theft therefore clearly is outside this paragraph, and it was on this paragraph alone that the claim to the allowance was based. Mrs. Lall has in support of her argument quite reasonably, in my opinion, said that if an embezzlement was rightly to be considered as an expenditure the same reasoning by which it was so held would also apply to a theft and therefore urged that the decision to which I have referred ought to be considered as much an authority in favour of a claim for allowance by theft, as it expressly was for an allowance by embezzlement. I think this argument is sound, and for that reason I am of opinion that the decision of Ross, J., was erroneous. But the decision itself was based on a case of embezzlement and it was reasoned on the basis of embezzlement and therefore it is not an authority for the proposition that loss by theft is equally allowable. I would make the same observation in respect of the dissenting judgment of Ayyar, J., in the case of *S. P. S. Ramaswami Chettiar v. The Commissioner of Income tax, Madras* (I.L.R. 53 Madras 904). In that case there had been a loss which was incurred by theft of money in a money-lending business, and it was held by the majority of the learned Judges that that could not be allowed for in computing the income tax. The dissenting judgment of Ayyar, J., was on somewhat the same lines as the decision of this Court in *Jagarnath Therani v. Commissioner of Income tax* and is to my mind equally open to objection. Should a case arise in which a claim to loss by embezzlement is made, it will be necessary to reconsider the decision in *Jagarnath Therani v. The Commissioner of Income tax*.

In my opinion the Commissioner of Income tax was right in disallowing this claim, and the answer to the second question "Whether in the circumstances the sum of Rs. 2,365 should be lawfully deducted from the assessee's return" should, in my opinion, be in the negative. The assessee having failed must pay the costs of the Department, which we assess at rupees one hundred and fifty.

AGARWALLA, J.—I agree.

[IN THE ALLAHABAD HIGH COURT].

KEDAR NARAIN SINGH

v.

COMMISSIONER OF INCOME TAX, C. P. & U. P.

COLLISTER and BAJPAI, JJ.

January 4, 1938.

HINDU UNDIVIDED FAMILY—ESTATE UNDER COURT OF WARDS—MONTHLY ALLOWANCE PAID TO DAUGHTER'S SON OF FEMALE OWNER WHETHER EXEMPT—'INCOME'—'HINDU UNDIVIDED FAMILY'—RULE AGAINST DOUBLE TAXATION—SCOPE OF EXEMPTION UNDER SEC. 14 (1)—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 14 (1)—COURT OF WARDS ACT (IV OF 1912), Sec. 25.

An estate was under the management of the Court of Wards. The proprietor of the estate and the ward for the time being was the widow of the last male owner. The assessee who was the daughter's son of the widow and the prospective heir to the estate, received from the Court of Wards Rs. 500 odd per mensem for his expenses out of the income of the estate. The question being whether the assessee was liable to be assessed to income tax in respect of this amount: Held, (i) that the allowance received by the assessee was 'income' of the assessee within the meaning of the Income Tax Act and not a mere expense incurred by the Court of Wards on his behalf; (ii) that it was neither agricultural income nor a casual and non-recurring receipt; nor was it exempt from tax under Sec. 14 (1) as sum received as member of a Hindu undivided family, and it was therefore liable to be taxed in the assessee's hands.

Only those members of a Hindu undivided family can claim exemption under Sec. 14 (1) of the Act who either on partition would be entitled to demand a share or are entitled to maintenance under Hindu Law and who therefore might be said to have an interest in the joint income of the property. A daughter's son who, as prospective heir to an estate, receives an allowance from the income of the estate does not receive it as member of a joint family within Sec. 14 (1).

The word 'income' is a word of elastic ambit, and though the Courts have attempted to give a certain description to the word, they have always qualified the said description by saying that it is not exhaustive. It is however clear that the words 'income, profits and gains' are used in the Act in a disjunctive sense and the word 'income' is not limited by the words 'profits and gains'.

Anything which can properly be described as income is taxable under the Act unless expressly exempted.

Cases referred to :

COMMISSIONER OF INCOME TAX, BOMBAY *v.* LAXMINARAIN [1935] (59 Bom. 618 ; 1935 I.T.R. 367 ; 8 I.T.C. 239 ; A.I.R. 1935 Bom. 412).

MAHARAJKUMAR GOPAL SARAN NARAIN SINGH *v.* COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1935] (1935 I.T.R. 237 ; 8 I.T.C. 340 ; 39 C.W.N. 1093).

VEDATHANNI *v.* COMMISSIONER OF INCOME TAX, MADRAS [1933] (56 Mad. 1 ; 1933 I.T.R. 70 ; 140 I.C. 70 ; 63 M.L.J. 542).

Reference under Sec. 66 (2) of the Indian Income Tax Act, XI of 1922, submitted by the Commissioner of Income Tax, Central and United Provinces, [Miscellaneous Case No. 415 of 1935].

STATEMENT OF CASE.

Case stated by the Commissioner of Income tax, Central and United Provinces under Section 66 (2) of the Income tax Act XI of 1922 (hereinafter referred to as the Act) at the instance of Kunwar Kedar Narayan Singh, an individual within the meaning of Sec. 3 of the Act (hereinafter referred to as the assessee) for the decision by the Hon'ble the High Court of Judicature at Allahabad, of the question of law set forth in paragraph 3 of this statement arising out of the appellate decision of the Assistant Commissioner of Income tax, Benares, in respect of the assessment to income tax for the year ending 31st March 1934.

2. **Facts of the Case.**—The Ausanganj Estate is under the superintendence of the Court of Wards, Ghazipur. The ward, the present proprietor of the estate, is Rani Ram Kunwar Sahiba. The Rani has no male issue. The assessee is her daughter's son who by virtue of his relationship is regarded as the prospective heir to the estate. He has no right to the estate during the lifetime of Rani Ram Kunwar Sahiba but a right of reversion on her death. In view of this fact the assessee is in respect of a maintenance allowance which, at Rs. 541-8-0 a month, works out to Rs. 6,498. This allowance the Income Tax Officer assessed along with other income to income tax for the year in dispute. A copy of the assessment order is annexed as Appendix A. Dissatisfied with the assessment, the assessee appealed to the Assistant Commissioner contending (i) that the allowance was paid to him as a member of a Hindu undivided family and was in consequence exempt under Sec. 14 (1) of the Act, and (ii) that it was also exempt as agricultural income.

The Assistant Commissioner overruled both the contentions and dismissed the appeal. A copy of his appellate order will be found in Appendix B. The assessee has now presented an application demanding a reference under Sec. 66 (2) unless I cancel the assessment. I am at one with the officers below and am unable to comply with the assessee's request under Section 33.

3. Question for the Decision of the Hon'ble the High Court.—I accordingly refer the question propounded by the assessee, namely :

"Whether under all the circumstances of this case taken together with due regard to the provisions of Sec. 25 of the Court of Wards Act and Sec. 41 of the Income tax Act the petitioner is liable to be assessed to income tax under the Indian Income tax Act, 1922".

4. Opinion of the Commissioner.—Section 25 of the Court of Wards Act (IV of 1912) runs as follows :

"The Court of Wards may from time to time determine what sums shall be allowed in respect of the expenses of any ward and of his family and dependants".

There is no dispute as regards the fact that the income of the Court of Wards is assessed to income tax. The sole question is whether this fact confers an exemption on allowances paid to the dependants of the ward. The assessee is not a member of a Hindu undivided family with the ward. He belongs to the family of the ward's daughter. Section 14 (1) is not, therefore, applicable to this case nor is the allowance agricultural income in the hands of the assessee. It is intended for the personal expenses of the assessee and is a recurring allowance. Section 4 (3) does not, therefore come in. I am not aware of any provision in the Act under which an allowance is exempt from income tax. That it is so exempt is a matter the burden of proving which is on the assessee. As the allowance is not covered as regards its exemption by any provision of the Act I am of the opinion that it has been rightly assessed to income tax. My submission, therefore, is that the question should be answered in the affirmative.

As required by rule 7 of the rules framed by the High Court a relevant portion of the statement of the case was sent to the assessee for observations and suggestions, if any, to be made within 14 days of the receipt of it. It was received by him on the 8th July 1935, and although the stipulated time has expired no communication has yet been received from him. It seems that the applicant is not keen about it and no useful purpose is likely to be served by waiting further".

JUDGMENT.

BAJPAI, J.—This is a reference under Sec. 66 (2) of the Indian Income Tax Act by the Commissioner of Income tax, Central and United Provinces. The facts as found by the revenue authorities, may be summarised :—

The Ausanganj Estate is under the superintendence of the Court of Wards, Ghazipur. The proprietor of the estate and the ward is *Mst. Rani Dulhin Ram Kunwar*, who is the widow of *Babu Sri Narain Singh*, the last male owner of the estate. The assessee is *Babu Kedar Narain Singh*, the daughter's son of the Rani and he by virtue of his relationship is regarded as the prospective heir to the estate. He has been assessed to income tax for the year ending the 31st March 1934 on an income of Rs. 6,498 along with other income about which there is no dispute. It is, however, said that the sum mentioned above ought not to have been included in the income of the assessee for the year in dispute. This amount is paid to him under Sec. 25 of the Court of Wards Act. That provision reads as follows :—

“The Court of Wards may from time to time determine what sums shall be allowed in respect of the expenses of any ward and of his family and dependants”

and the contention of the assessee is that the alleged income is actually the amount of personal expenses of the petitioner incurred by the Court of Wards under Sec. 25 of the Court of Wards Act, as the petitioner is a dependant of the Ward. The Income Tax Officer, the Assistant Commissioner of Income Tax and the Commissioner of Income tax are of the opinion that the assessee is liable to be taxed on the above income, but on the application of the assessee the following question has been formulated by the Commissioner of Income-Tax and referred to us for opinion :—

“Whether under all the circumstances of this case taken together and with due regard to the provisions of Sec. 25 of the Court of Wards Act and Sec. 41 of the Income Tax Act the petitioner is liable to be assessed to income tax under the Indian Income Tax Act, 1922”.

Sec. 41 of the Act simply says that “in the case of income, profits or gains chargeable under this Act which are received by the Court of Wards.....the tax shall be levied upon and recoverable from such Court of Wards.....in the like manner and to the same amounts as it would be leviable upon and recoverable from any person on whose behalf such income, profits or gains are received, and all the provisions of this Act shall apply

accordingly". This section has really no bearing on the point that has got to be determined; it deals only with the liability of the Court of Wards in respect to the income of the ward which comes into its hands. There are really two questions that arise in connection with this reference. The first is whether the sum of Rs. 6,498 can be regarded as the income of the assessee, and if this question is answered in the affirmative, the next question is whether the assessee can claim any exemption. Now, an attempt to define the word 'income' has baffled the Legislature and Judges. The Act itself does not define it, and in Sec. 6 the best that has been done in this respect is to say what heads of income, profits and gains shall be chargeable to income-tax, and under these heads we find the following sub-heads :—

- (i) Salaries.
- (ii) Interest on securities.
- (iii) Property.
- (iv) Business.
- (v) Professional earnings.
- (vi) Other sources.

Although in the succeeding provisions an attempt has been made to describe the first five sub-heads, Sec. 12 deals with the omnibus sub-heading of 'other sources', and all that could be said there was that 'other sources' included "income, profits and gains of every kind and from every source to which this Act applies". It is, therefore, clear that the word 'income' is an expression of elastic ambit, and courts when considering whether any particular sum can be said to be the income of an assessee have attempted either to bring it in, or to exclude it from, a certain description which they have chosen to give to the word 'income' but they have always qualified the said description by saying that it is not exhaustive. It is, however, clear that the words "income, profits and gains" used in the Act are used in a disjunctive sense, and the word 'income' is not limited by the words "profits and gains". As observed by their Lordships of the Privy Council in the case of *Maharaja Kumar Gopal Saran Narain Singh v. Commissioner of Income Tax, Bihar and Orissa*, "anything which can properly be described as income is taxable under the Act unless expressly exempted". That perhaps is the best definition, although it may be said to be tautologous.

There can be no doubt that the entire income of the Ausanganj Estate is taxed in the hands of the Court of Wards, and in one sense it may be said that any sum paid to the assessee in respect

of his expenses as a dependant of the ward has been taxed, but the main question is whether the Income Tax Department is offending against the rule of double taxation in the true sense of the term, for it must be conceded that an income which has been taxed may again be taxed, when it is spent by the original assessee in the shape of salaries and allowances paid by the assessee to its servants or dependants. The real point is whether the sum of Rs. 6,498 represents only the expenses of the ward and retains that character all along or whether at some stage it becomes the income of the assessee in the course of transmission. The marginal note to Sec. 25 is "allowances for ward and his family", and although the marginal note may not be taken into account in order to interpret the section itself, there can be no doubt that the section may be paraphrased as follows :

"The Court of Wards may from time to time determine the allowances of the ward and of his family and dependants in respect to their expenses".

If this paraphrasing is not violent in any respect, then the sum can be treated as an allowance paid by the Court of Wards to the assessee and would stand on the same footing as, for instance, the salary paid to the tutor of a ward. The discretion of the Court of Wards may not be questioned in any civil court, (*Vide* Sec. 53 of the Act), and it may not be possible for anybody to say that the Court of Wards was wrong in treating the assessee as a dependant of the ward or in fixing for him an allowance of Rs. 6,498 a year, but it is not possible to say that this sum is only an expense of the ward and does not become an income of the assessee. This sum is within the absolute control of the assessee and neither the Rani nor the Court of Wards can call upon him to render account in respect thereto. We are, therefore, of the opinion that this sum was rightly treated as income by the revenue authorities.

The next question is whether the assessee is entitled to claim exemption in respect of this sum. Before the Income Tax Officers it was contended that the sum received by him was agricultural income, but this contention was not advanced before us. The assessee is only a reversioner of the estate and not the owner thereof during the lifetime of the present incumbent, and the allowance having been paid out of the agricultural and taxed income of the estate may be taxed again when it passes from the owner of the estate to the assessee, for in his hands the character of the income has been changed. If it is treated as a gift, it would be liable to tax and would not be exempted under Sec. 4 (3) (vii)

because it is not an insulated gift and is not an income of a casual and non-recurring nature, but is a gift of a periodical and regular kind, even if it be said to be made to the assessee by the ward out of considerations of love and relationship.

The chief contention that is advanced before us is that the assessee can claim exemption under Sec. 14 (1) of the Act which says that the tax shall not be payable by an assessee in respect of any sum which he receives as a member of Hindu undivided family. In this connection we have to consider whether the assessee can be treated as a member of a Hindu undivided family. Ordinarily, a married daughter is not a member of the family of her father or mother, nor can the daughter's son be said to be such a member, but it is said that the expression 'undivided Hindu family' used in Sec. 14 differs from what is called a Hindu coparcenary body which is a much narrower body and which includes those male members who take by birth an interest in the coparcenary property. This may be conceded and is indeed supported by authority, see the case of *Vedathanni v. Commissioner of Income tax, Madras* (I.L.R. 56 Mad. page 1) and the case of the *Commissioner of Income tax, Bombay v. Laxminaryan* (I.L.R. 59 Bom. p. 618). In the latter case Rangnekar, J., observed that under the Hindu Law an undivided family is composed of (a) males and (b) females. The males are (1) those that are lineally connected in the male line, (2) collaterals, (3) relations by adoption and (4) poor dependants, and the learned Judges referred to *Mayne's Hindu Law* at page 344, where the learned author speaks of it as "the whole body of such a family consisting of males and females.....some of the members of which are coparceners, that is persons who on birth would be entitled to demand a share, while others are only entitled to maintenance", and to what has been said in the same book at page 347 that "now it is at this point that we see one of the most important distinctions between the coparcenary and the general body", and then finally a reference was made to the description of a Hindu undivided family as given by Dinshaw Mulla in his *Principles of Hindu Law*, 7th Edition at page 230, in these words, "A joint Hindu family consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters". Accepting all that was said by the learned Judge, it is clear that the assessee is neither lineally connected in the male line, nor a collateral nor a relation by adoption, and the best that can be said is that he is a poor dependant, and it is in that category that the assessee is brought by learned counsel for

the assessee, and reliance once again is placed on the fact that under Sec. 25 of the Court of Wards Act the assessee is receiving something for his allowance and the allowance is paid to him because he is a dependant of the Ward. It is difficult to consider the assessee as a poor dependant in the sense in which that expression is used in the judgment of the learned Judge of the Bombay High Court, and the learned Commissioner says that the assessee "is regarded as the prospective heir to the estate" and it is in that capacity that the allowance is paid to him so that he may live up to the standards of the future owner of a big property. The assessee cannot at all be regarded as a poor dependant in the sense in which that term is understood in Hindu Law, and the expression 'dependants' used in Sec. 25 of the Court of Wards Act is a wholly different expression. Only those members of a Hindu undivided family can claim exemption under Sec. 14 (1) of the Act who either on partition would be entitled to demand a share or are entitled to maintenance under the Hindu Law and who therefore might be said to have an interest in the joint income of the family. The assessee is entitled neither to claim partition nor to claim maintenance as of right nor has the sum in question been received by him by virtue of his position as a member of the Hindu undivided family and, therefore, the exemption provided in Sec. 14 (1) is not available to him.

Our answer, therefore, to the question formulated by the Commissioner mentioned in an earlier portion of our judgment is in the affirmative, and we direct that a copy of our judgment shall be sent under the seal of the Court and the signature of the Registrar to the learned Commissioner of Income Tax, Central and United Provinces. The assessee must pay the costs of the reference. The hearing of the case lasted for a day, and we allow six weeks' time to counsel for the Department to file his certificate. We fix the fee for the counsel for the Department at Rs. 200.

• Question answered in the affirmative.

[IN THE CALCUTTA HIGH COURT].

BISSENDOYAL DOYARAM, *In re.*

COSTELLO and LORT-WILLIAMS, JJ.

May 6, 1937.

BAD DEBT—FAMILY BUSINESS—PARTITION—DEBT ALLOTTED IN PARTITION BECOMING BAD—WHETHER ALLOWABLE AS BAD DEBT—CAPITAL LOSS OR TRADING LOSS—QUESTION OF SUCCESSION.

A Hindu undivided family consisting of one Gajanand and his son Doyaram carried on business in stock and share brokerage under the style of 'Bissendoyal Gajanand'. In a partition between the father and the son effected under an award in 1924, the son was given a share in the co-parcenary property and a debt due from a third person which, though nominally of the value of Rs. 1,13,535, was assessed for purposes of partition as being only of the value of Rs. 22,052. As the son was not able to recover this debt, he wrote it off as a bad debt in the account year 1934 and claimed that the whole amount of Rs. 1,13,535 or at least the sum of Rs. 22,052 should be deducted as a bad debt in assessing his taxable income for the year 1934. Under the award the father was allowed to use the old trade name of 'Bissendoyal Gajanand' and was also allowed to retain the membership of the Stock Exchange Association. The son was allowed to carry on a separate business in the name of 'Bissendoyal Doyaram':

Held, that the son was not a successor to the old business; what he actually got was a share in the assets of the old business which became capital in his hands, and the loss being in the nature of capital loss, could not be allowed as a bad debt.

Case stated by the Commissioner of Income Tax, Bengal, under Sec. 66 (2) in the matter of the assessment of Bissendoyal Doyaram for the year 1934. [Reference No. 1 of 1937].

The Commissioner's statement of case was as follows.

CASE.

"The assessee in this case assessed as a Hindu undivided family consisting of Doyaram and his minor sons has asked me to refer to the Hon'ble High Court under Sec. 66 (2) of the Income Tax Act the following question of law which according to it has arisen out of the orders of the Assistant Commissioner in appeal.

"Where an assessee carrying on business of sharebroker and dealer satisfies the Income Tax Officer that a debt written off by him in the previous year upon settlement with the debtor arose out of his share business carried on up to 1924 in conjunction with his then coparcener and such debt had been allotted to him on family partition whether it is legal to disallow such loss by bad debt on the ground of capital loss only though in previous assessment proceedings the outstandings obtained by the assessee on partition were held to be business outstandings".

2. The matter relates to the assessment for the year 1935-36 on income from interest on securities, house property, business of dealing and brokerage in shares and other sources (dividend). In computing the income from business, the Income Tax Officer did not allow a debit of Rs. 1,01, 535-3-0 which was written off by the assessee as a bad debt of one M. G. Marcar in his (assessee's) accounts for the relative accounting period which is 1990-91 *Dewali*, corresponding to the year ended October, 4, 1934. The assessee's claim is that the deduction of this amount as a bad debt should have been allowed as it was a bad debt. The facts are that originally, there was a business in shares and brokerage of the Hindu undivided family governed by the Mitakshara law styled Bissendoyal Gajanand. This family consisted of Gajanand and Doyaram son of Gajanand among others. Both Gajanand and Doyaram were looking after the business. On account of a transaction relating to the business which Doyaram made without consulting his father, there was loss and Gajanand who was the *karta* of the family refused to pay this loss. A dispute thus arose between Gajanand, the father and Doyaram, the son. The latter insisted on a partition and the matter went to the High Court in Suit No. 402 of 1923. It however ended in arbitration on the 30th April, 1934. A copy of the award is appended (Appendix 'A'). The relevant extracts are given below :—

"7. As regards the outstandings due from the debtors of the firm with or without securities, it is agreed on the 30th April 1924 by and between the parties that they would be put to auction. Subsequently that was varied and it was agreed that the parties or either of them would give the arbitrators their valuation or amount that they expect to realise from each of the said debtors on accounts and that the arbitrators would allot to the parties the said outstandings as they would think proper at such prices as they may fix. Accordingly we allot the following outstandings to Gajanand Poddar at the prices mentioned against them.

(Here is a long list of names and amounts against each).

The securities in the aforesaid accounts are to be retained by the defendant Babu Gajanand Poddar.

We award and allot the following outstandings to the plaintiffs (Doyaram was the plaintiff) including the defendant Sm. Jhimi at the prices mentioned against them.

*	*	*	*
M. G. Marcar			22,012
*	*	*	*

13. As regards the name and goodwill of the firm we award that the defendant Gajanand Poddar will be entitled to use the firm name of Bissendoyal Gajanand and the membership card or share in the Calcutta Stock Exchange Association, Limited, standing in the name of Bissendoyal Gajanand shall be the exclusive property of the defendant Gajanand Poddar. The plaintiff or the defendant Sm. Jhimi will not be entitled to carry on business in that firm name. They may, if they like, use the name of Babu Bissendoyal with any of their own names, e.g., Bissendoyal Doyaram.

14. We direct the defendant Gajanand Poddar to pay to the plaintiffs the sum of Rs 7,000 only to enable the plaintiff Doyaram Poddar to have his name enlisted as a member of the Calcutta Stock Exchange Association Limited.

15. We direct the defendant Gajanand Poddar to pay to the plaintiffs including the defendant Sm. Jhimi, the sum of Rs. 3,33,129-4-6 as representing their share of the cash rents, and all realisations and the remaining outstandings less expenses allowed on joint account. The balance of the cash rents realisations, etc., and all cash claims and outstandings (including all outstandings for rents, interest, advances, deposits up to the 31st May, 1924) except those particularly allotted to the plaintiffs including the defendant Sm. Jhimi by this award are to remain with and shall belong to the defendant Gajanand Poddar exclusively".

The old business together with goodwill and some part of the outstandings came over to the father Gajanand, while Doyaram the son was given the value of the remaining outstandings. What the parties appear to have done is that the outstandings were valued as on 30th April 1924 and the particular outstanding with which we are concerned, *viz.*, in the name of one M. G. Marcar came over to Doyaram, the son. Although the outstanding was shown in the books as being Rs. 1,13,535-3-0 it was valued at Rs. 22,052 by the arbitrators as will be found from the recital above. It may be noted that so far as this valuation is concerned

Marcar, the debtor was not a party. Doyaram started a distinct business of his own in shares having become a member of the Calcutta Stock Exchange Association Limited. The membership card of the old business in the name of Bissendoyal Gajanand went over to the father according to the arbitration award. The new business of the son was styled Bissendoyal Doyaram (the assessee before me) and it is continuing even now. The assessee claims that this bad debt of Marcar is in connection with the business on which he is being assessed, but what he got as the result of the arbitration made on the 30th April 1924, was the portion of the assets of the old business styled Bissendoyal Gajanand. As already said, the business on which he is being assessed now is a new business, *i.e.*, is not the business in connection with which the debt of Marcar arose. As a matter of fact, it is found that the father Gajanand claimed in the past that the old business had been discontinued and he claimed the benefit of the provisions of Sec. 25 (3) of the Income tax Act. The present assessee that is Doyaram, the son, was assessed on the new business for the first time in the year 1925-26, while Gajanand the father was assessed on the old business for the year 1925-26 after which no assessment has been made on him on the old business because he died and his business ceased to exist. I find from the records that the assessment for the year 1926-27 was made on the executor to the estate of Gajanand Poddar on behalf of minor Satya Narayan Poddar, the income being from house property, dividend and interest. There was no business income which was assessed on Gajanand or his estate. It has been argued on behalf of the assessee that as Bissendoyal Doyaram has been carrying on business in shares, the bad debt in respect of Marcar should be allowed in his assessment. He also refers me to the fact that for the assessment year 1926-27 the Assistant Commissioner had allowed as bad debts (other than of Marcar) certain of the outstandings which the assessee got as the result of the arbitration award, dated the 30th April 1924 and he therefore wants me to hold that as bad debts have been allowed in that year the same principle should be followed in the case of Marcar also. It is also true that the Income tax Officer in the assessment year 1928-29 allowed as a bad debt an outstanding (other than that of Marcar and distinct from those allowed by the Assistant Commissioner of Income tax for the assessment year 1926-27 which came to the assessee as the result of the award, dated the 30th April 1924, but these facts do not mean that if they were wrongly allowed in the past, the same wrong principle should

be followed now. I find that in the assessment for the year 1930-31 a similar claim was disallowed. So far as the particular debt in respect of Marcar is concerned it is found that the assessee made arrangements with the debtor (Marcar) in which it was stipulated that Marcar would pay to the assessee a sum of Rs. 4,000 only by monthly instalments of Rs. 80 and that on the payment of this Rs. 4,000 the assessee would compound the whole debt of Rs. 12,000 including the sum of Rs. 4,000 referred to. When the family properties were divided, as stated in the beginning of this statement, Mr. Marcar's debt amounted to Rs. 1,13,535-3-0. For the purpose of partition, however, this was valued only at Rs. 22,052 and this latter figure was taken to be the assets of the family on this count available for the purpose of division. As has already been stated the son Doyaram got this debt as the result of the division. Subsequently there was a composition arrived at between Doyaram and Marcar on the 15th August 1934 whereby the debt was settled at Rs. 12,000. The assessee contends that as the debt of Rs. 1,13,535-3-0 has thus been settled at Rs. 12,000, the difference has thereby become a bad debt and he claims allowance for the difference, viz., Rs. 1,01,535-3-0. Assuming for the sake of argument that any amount out of this is to be considered as a bad debt, as the value of the debt was Rs. 22,052 at the time of the division, his loss if any at all would be only Rs. 10,052.

3. In the facts and circumstances as stated above, the question of law which arises out of the order of the Assistant Commissioner under Sec. 31 of the Indian Income tax Act is, in my respectful opinion, the following :—

“Whether in view of the facts stated above the sum of Rs. 1,01,535-3-0, written off by the assessee in the year of account relating to the assessment for the year 1935-36, or any part thereof, should be allowed as a deduction from profits?”

Instead, therefore, of referring the question as framed by the assessee I refer the above question to the High Court for their Lordship's decision.

4. The amount aforesaid was a capital asset which came over to the assessee in the year ended October, 1924. It has nothing to do with the business which is being carried on by the assessee and if he could not recover or did not choose to recover something which he got not in connection with this business of his, what he has lost is a capital loss. The facts of the case as submitted herein above would go to show that the business of the assessee on which he is being assessed is a business which he started anew

after October, 1924 and the assets which he got in his share of the outstandings of the old family business valued at certain figures have nothing to do with his business which he is carrying on. Assuming that as the result of the arbitration on the disruption between the father and son, the son had got some house property as assets and in selling one of such houses he made a loss, could that loss be allowed to be set off against his income from the share business which he is carrying on?

5. I would, therefore, respectfully submit that their Lordships would be pleased to hold that the sum of Rs. 1,01,535-3-0 has been rightly disallowed by the Income tax Officer as a deduction from the profits for the assessment year 1935-36.

6. I append to the statement of case copies of the following documents:—

(1) Copy of the award in Suit No. 402 of 1923. (2) Assessment Order. (3) Grounds of Appeal. (4) Appellate Order. (5) Application under Sec. 66 (2).

JUDGMENT.

COSTELLO, J.—This matter relates to an assessment of the year 1935 on income from interest on securities, house property, business of dealing and brokerage in shares, and other sources. In computing the income from business, the Income tax Officer did not allow a debit of Rs. 1,13,535-3-0 which was written off by the assessee as a bad debt of one M. G. Marcar which has been standing in the accounts of the assessee for the relative accounting period for the year which was 1990-91 *Dewali*, corresponding to the year ending October, 1934. The assessee claimed that the deduction of the sum mentioned ought to have been allowed as a bad debt, because in fact it was a bad debt.

The facts out of which the matter arises are every short. Originally there was a stock and share brokerage business carried on by a Hindu undivided family which was subject to the Mitakshara school of Hindu Law, and that business was carried on under the style of Bissendoyal Gajanand. The family consisted of one Gajanand and his son Doyaram. Both these persons were engaged in the business. It appears that Doyaram entered into a transaction relating to the business without consulting the father, which transaction resulted in a loss. Gajanand as *karta* of the family refused to pay this loss. A dispute accordingly arose between Gajanand and Doyaram and the latter instituted a suit for partition which was suit No. 402 of 1923. This suit ended in an

arbitration on the 30th April 1924 and under the award of the arbitrators Doyaram was given a part of his share in the coparcenery assets and the debt due from M. G. Marcar which although nominally was Rs. 1,13,535-3-0, however was assessed for the purpose of the partition as being only of the value of Rs. 22,052.

Doyaram argued that the business which he was carrying on was really a part of the old business. The effect of the partition was to divide up the old business as between his father and himself, and that therefore when he himself conducted the business of a stock and share broker as from the date of the award in April 1924, he was actually carrying on a part of the old business, and therefore, he ought to be allowed to set off against the profit he made in the year in respect of which assessment was made, the sum which at that time was outstanding from M. G. Marcar. He contended that he ought to be allowed a set off of the full sum of Rs. 1,13,535-3-0 or at any rate the value of the debt as stated for the purpose of the partition.

The Income tax Officer disallowed this deduction on the ground that the amount due from Marcar was really in the nature of a capital asset which had come over to the assessee in the year ending in October 1924. The Commissioner of Income tax in the opinion which he had put before us said it, that is to say, the amount of Marcar's debt had nothing to do with the business which was being carried on by the assessee, and if he could not recover or did not choose to recover something which he got not in connection with the business of his, what he had lost was a capital loss.

The question which we are required to answer is whether or not the assessee should be allowed a debit either of Rs. 1,13,535-3-0 or the sum of Rs. 22,052. The material matter for our consideration is certain provisions in the award of the arbitrators. It appears that as regards the outstanding debts which were due to the old business at the time of the partition they were valued on the 30th April 1924 after due consideration as to the nature of the debts and probabilities of realisation; and according to the valuation which was made, a portion of the debts including the dues from Marcar, was allotted to Doyaram and the other portion to his father Gajanand.

Under the award Gajanand was allowed to use the trade name, and it seems, with the name went also the good will of the old business. He was allowed to use the name of Bissendoyal Gajanand for the business he was to carry on. He was allowed to retain the

membership of the Calcutta Stock Exchange^{*} Association Limited, and he was in fact given the entire share in the Calcutta Stock Exchange Association Limited, which was standing in the name of Bissendoyal Gajanand. On the other hand, his son Doyaram with whose assessment we are now concerned was allowed to carry on a separate business in any other name he should choose including a name which had in it, the name 'Bissendoyal' or 'Bissendoyal Doyaram' or any other combination except that of 'Bissendoyal Gajanand'.

It seems to follow, therefore, that the present assessee was not a successor to the old business. What he actually got was a share in the assets of the old business and that asset became capital in his hands. Therefore, it must be taken that this debt which was due from Marcar to the old business came into the hands of Doyaram not as a debt due to him in respect of the business which he was carrying on or was about to carry on, not as a debt of the old business, but simply as an asset which could be used as capital in his hands if he so chose to use it, assuming he could recover it.

In the circumstances, we are of opinion that the Income tax Officer was quite right in disallowing the deduction. The Reference is answered in favour of the Crown with costs to be taxed according to the scale of the Original Side of this Court.

LORT-WILLIAMS, J.—I agree.

Reference answered in favour of the Crown.

[IN THE KING'S BENCH DIVISION].

ALLEN AND MURRAY v. TREHEARNE (Insp. of Taxes)

LAWRENCE, J.

March 16, 22, 24, 1937.

EXECUTORS—CONTRACT OF SERVICE—PROVISION FOR PAYMENT OF LUMP SUM ON TERMINATION OF SERVICE—SERVICE TERMINATED BY DEATH OF EMPLOYEE—SUM PAID TO EXECUTORS—ASSESSABILITY—ENGLISH INCOME TAX ACT, (1918), GENERAL RULES, r. 18—FINANCE ACT, 1927, SEC. 45 (5) (6).

Where a sum of money payable under a service agreement upon the final termination from any cause whatsoever (other than wilful misconduct on the part of the employee) of the service and in lieu of a

pension is paid to the executors of the will of a deceased person who died while holding his office, income tax under Schedule E of the English Income Tax Act, 1918, is properly chargeable to the executors to the same extent as it would have been chargeable to the deceased had he continued to live.

Case stated by the Commissioners of Inland Revenue pursuant to Sec. 149 of the Income Tax Act, 1918 (8 and 9 Geo. 5. c. 40).

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on April 24, 1936, Frederick Allen and Stephen Murray, the appellants in this appeal appealed against an assessment to income tax under schedule E, for the year ending April 5, 1934, made upon them as executors of the will of Percy Murray deceased.

At the time of his death Percy Murray held the office of managing director of Lewis Berger and Sons Ltd., under a service agreement dated October 20, 1931. The period of service was ten years certain from August 1, 1930. Clause 4 of this agreement provided that the company should pay to the managing director by way of remuneration for his services, in addition to a fixed yearly salary and a commission on the net yearly profits: (c) a terminal sum of £ 10,000 with an addition thereto at the rate of £ 800 for each year of service after July 31, 1935, to be payable by the company to the managing director or his personal representatives upon the final termination from any cause whatsoever (other than the wilful default of the managing director in the performance of his duties) of his service with the company, whether such termination should take place under or during the subsistence of the agreement or any subsequent agreement for the extension of his service.

It was set out in the clause that in fixing the terminal payment, the company had taken account of the long service which the managing director had already rendered the company in one capacity or another, and that the managing director would accept it in lieu of expectation of pension.

It was a term of the agreement that Percy Murray might determine it by six months' notice after July 31, 1935, and a similar right was given to the company after 1941.

Percy Murray died on January 17, 1934, and on July 5, 1934, the company paid to the appellants as his executors the sum of £ 10,000 in accordance with clause 4 (c) of the agreement. Assessment was duly made upon the appellants to charge this sum.

It was contended on behalf of the appellants: (1) that the sum of £ 10,000 was neither received nor receivable by Percy Murray in his lifetime, and accordingly he himself never became chargeable with income-tax in respect of it; (2) that neither rule 18 of the General Rules, Income Tax Act, 1918, nor Sec. 45 (6) of the Finance Act, 1927, authorised the making of an assessment on executors in the circumstances: (3) that the assessment ought to be discharged.

It was contended on behalf of the Crown that the assessment has been properly made on the appellants as executors.

The Special Commissioners found that upon the death of Percy Murray his office ceased and thereupon the sum of £ 10,000 became payable by the company to his executors. Although Percy Murray did not become entitled to this sum at any moment during his lifetime it was, in their opinion, a profit of his office for the year in which he died.

They held that the executors were liable to be assessed in respect of this sum under sub-section 6 of Sec. 45 of the Finance Act, 1927, that in the case of the death of a person holding an office or employment, sub-sec. 5 came into play and fixed the amount of the charge. Sub-sec. 6 was not, in their opinion to be read as raising the hypothetical question of what would have been the charge supposing the deceased had not died but had ceased to hold the office of employment from some other cause. It was simply in aid of the charge which is ascertained under sub-sec. 5 and provides that the tax which has become chargeable under sub-sec. 5 and which would have become chargeable upon the deceased if he had not died, shall be assessed and charged upon his executors.

They confirmed the assessment.

The appellants appealed.

The arguments of counsel on behalf of the appellants and the respondent respectively are set out in the judgment.

Needham, K. C., and *Terence Donovan* for the appellants.

Attorney General (Sir Donald Somervell, K. C.) and *R. P. Hills* for the Crown.

JUDGMENT.

LAWRENCE, J.—stated the facts, and continued: It is contended by the appellants that Section 45 (5) of the Act of 1927 does not contemplate death and that sub-sec. 6 only applies to cases where a person ceases to hold office and dies thereafter; secondly, that

the £10,000 did not come to the deceased as his income, and therefore is not liable to tax, and, lastly, that it cannot be said that if he had not died, tax would under the provisions of sub-sec. 5 have become chargeable, because he might have ceased to hold his office through misconduct, in which case, he would not have received the £10,000 and would not have become chargeable to tax on that sum.

I am of opinion that these contentions are unsound. In my opinion, under sub-sec. 6 of Section 45 of the Finance Act, 1927, the Commissioners have to see whether, if the person had not died, tax would have been chargeable under sub-sec. 5 in the circumstances which have happened. They are not directed to make any other supposition except that the deceased had not died.

For the rest, the facts which have actually happened—namely, that he has ceased to hold office and has received or become entitled to certain emoluments—must be looked to and the same tax charged on his executors as would have been charged on him.

If the Commissioners are not to have regard to the facts as they have happened, to what are they to have regard? They might suppose anything and the sub-section only refers to the one supposition—namely, that the deceased had not died—and gives no other guidance. The fact that the deceased could never have received the £10,000 himself if he died in office is, in my view, irrelevant since the sub-section directs that the tax is to be chargeable as if he had not died. I cannot read the sub-section as confined to cases in which the deceased has ceased to hold office before his death, since its terms seem to me to include the case where he ceases to hold office by reason of death. Nor do I think that it is proper to have regard to any fact which has not occurred, but only to the death.

I therefore agree with the decision of the Commissioners and dismiss the appeal with costs.

Appeal dismissed.

Note.—Section 45 (5) of the Finance Act, 1927 provides: "Where in any year of assessment a person ceases to hold an office or employment or to be entitled to an annuity, pension or stipend chargeable under Sched. E, tax shall be charged for that year on the amount of his emoluments for the period beginning on the sixth day of April in that year and ending on the date of the cessation....." Sub-section 6 reads: "In the case of the death of a person in whose case, if he had not died, tax would under the

provisions of the last preceding sub-section, have become chargeable for any year, that tax which would have been so chargeable shall be assessed and charged upon his executors, or administrators and shall be a debt due from and payable out of his estate." Rule 18 of the General Rules applicable to schedules A, B, C, D and E of the Income Tax Act, 1918 provides: "Where any person dies without having delivered a statement of all his profits or gains chargeable to tax with a view to an assessment thereon in due course, an assessment in respect of the profits or gains which arose or accrued to him before his death may be made at any time within the year of assessment.....upon his executors or administrators, and the amount of the tax thereon shall be a debt due from and payable out of his estate".

[IN THE NAGPUR HIGH COURT].

BHAGAVANDAS HARIKISHANDAS

v.

COMMISSIONER OF INCOME TAX, C. P. & U. P.

SIR GILBERT STONE, C. J., and BOSE, J.

November 30, 1937.

FAMILY FIRM—INCLUDING FEMALE MEMBERS AS PARTNERS TO EVADE INCOME TAX—REFUSAL TO REGISTER FIRM—LEGALITY—REFERENCE—TRANSFER TO FICTITIOUS FIRM—VALIDITY—SUCCESSION—MERE AGREEMENT TO TRANSFER—EFFECT—INDIAN INCOME TAX ACT (XI of 1922), SECS. 26-A, 26 (2).

A firm consisted of the managing members of three joint Hindu families. The number of partners was increased by eleven members one being the wife of one of the partners and the other ten, the wives of the sons of the other partners. The income tax authorities took the view that these persons were merely included to increase the number of shares with a view to evade income tax and that the firm as constituted was fictitious and refused to register it. This firm then transferred its rights and assets to another firm of Bombay alleged to consist of the three managing members and the husbands of the ten ladies; the Income Tax Officer refused to recognise the transfer holding it to be fictitious: Held, that the findings were findings of fact, and being based on evidence, there was no ground for directing a reference under Sec. 66 (3).

Held also, that Sec. 26 (2) of the Act only applies if there is a transfer before assessment. A mere agreement to transfer would not bring the said provision into operation.

Application for an order requiring the Commissioner of income-tax, Central and United Provinces, to state a case and to refer it to the Court, under Sec. 66 (3) of the Indian Income-tax Act XI of 1922.

Messrs. W. R. Puranik and R. K. Rao for the Applicant.

R. B. D. N. Chaudhuri for the Opposite Party.

JUDGMENT.

BOSE, J.—This is an application made by an assessee under Sec. 66 (3) of the Indian Income-tax Act following upon an unsuccessful application to the Commissioner of Income-tax under Sec. 66 (2). The application asks that a mandamus do issue to the Commissioner calling upon him to state a case. It is conceded that the application fails unless there is some point of law for the Income Tax Commissioner to state. In our opinion, it fails because there is no point of law.

The case raises two questions both of which, in our opinion, are questions of fact and neither of them is capable of forming the subject-matter of a case unless it is possible to say that the conclusions of fact arrived at by the assessing officer have been arrived at either without any evidence whatever or because he has misdirected himself. It is said that he has misdirected himself here by viewing the circumstances from a wrong angle due to the fact that he has persuaded himself that the various steps taken by the assessee, which will be mentioned hereafter, are steps taken simply to defraud the income tax law; and it is as a consequence of this basis that he has arrived at his conclusion.

The facts of the case are very clearly stated and at considerable length in the assessment order and we do not propose to recapitulate them at any length. Put broadly it may be said that we are concerned with two firms Baghavandas Harkishandas, (the assessee) and Narayandas Kedarnath. The first major question that arises is whether the firm of Baghavandas Harkishandas, as at present constituted, is entitled to be registered. Registration under the Income tax Act has been refused on the ground that as at present constituted it is a fictitious firm comprising of a number of persons included for no *bona fide* reason but merely for the purpose of increasing the number of shares into which the profits can be divided for income tax purposes. The question is: Is there evidence to support that conclusion? The matter has already

been the subject of a decision between the Income tax authorities and the assessee, for when the constitution of the firm was exactly the same as at present, the income tax authorities challenged the genuine nature of the firm, held that eleven of the members were mere names added to swell the number of shares simply for income tax purposes, and refused to register the firm. The necessary objections were taken; the decision was contested, the matter got as far as an application to the Commissioner under Sec. 66 (2) and the application failed. There was no application made for the stating of a case under Sec. 66 (3). So far, therefore, as that year of assessment was concerned, the matter stood thus; that the income tax authorities had held that this firm was not a genuine firm containing a large number of partners and could not be registered under the Income Tax Act. That decision had been contested as far as the Commissioner but the High Court had not been applied to for an order calling upon the Commissioner to state a case. So far as the next year of assessment, the one under consideration, is concerned, the same dispute was raised; the matter was further considered. The same conclusion was arrived at. The assessee now applies under Sec. 66 (3).

The broad facts on which the Income tax authorities came to the conclusion that the firm was not a genuine one can be stated as follows :

The firm had formerly consisted of the managing members of three joint Hindu families, the heads of those families having joined together to carry on business. That is a perfectly normal thing to find in this part of India. Next we find the number of the partners increased by eleven. The eleven new members are all women; one is the wife of one of the former partners, the others are wives of the various sons of the three managing members.

Bearing in mind the legal incidents which follow the membership of a joint Hindu family, bearing in mind the interest or the lack of interest which such women would have in the property of the joint Hindu families concerned, bearing in mind, the past history of this firm, we are clearly of the opinion not only that the income tax authorities were justified in the view they took as to the nature of the alleged new firm but we fail to see how they could come to any other conclusion than the conclusion they have, *viz.*, that the addition of the eleven names had no purpose or meaning except to enable the assessee to increase the number of shareholders for income tax purposes. That disposes of the first point, for the conclusion reached amounts to this: that the finding of

fact does not proceed on the evidence, nor does it proceed on a misdirection: and therefore no point of law arises.

The second point relates to a development of the manoeuvre which failed in the year of assessment 1931-32. The Income tax authorities having held that the addition of these names to this firm was merely for purposes of evading liability under the income tax laws, an attempt was made to get away from this income tax authority and get assessed by the Bombay income tax authorities. The plan of campaign appears to have been as follows: The firm that would have been assessed by the Nagpur authorities, *viz.*, the assessee firm Baghavandas Harikishandas, purported to transfer the business and all its assets and rights to the firm of Narayandas Kedarnath in Bombay. Section 26 (2) of the Income Tax Act would operate to entitle the transferring assessee to resist assessment in Nagpur and have the assessment made in Bombay. The question thereupon arose whether that transfer was unreal or not. Again it is said that the Income Tax authorities have had their view coloured by the suspicion that the whole thing was simply an expedient to evade income tax liability. It is said that it is a real transfer and the mere fact that it results in a lessened income tax liability does not make ineffective what is lawful. Granted the premises, we have no doubt about the conclusion.

There are two difficulties however, in the present applicant's way either of which is alone fatal. The first is that Sec. 26 (2) only applies if the transfer is before the assessment. All that took place before the assessment was an agreement to transfer and it is not disputed that at all relevant times there was no actual conveyance. There was nothing done to carry out the agreement. There has been some mention before us of Sec. 23-A of the Transfer of Property Act, but if one thing is clear about that much debated section, it is that it does not create a transfer where there is no completed transfer. It merely enables a person who is entitled to call for a transfer to raise certain defence. In our opinion, the fact that there was no transfer at all material times puts an end to the claim of this assessee to be relieved of assessment here and to have the assessment made in Bombay.

The second difficulty is that here again there is no point of law involved unless there is no evidence to support the finding of fact. The finding of fact is to the effect that the transfer is unreal. When one looks at the circumstances of the case it is apparent that the transfer is a mere expedient to evade assessment by an

authority that has shown an intention to deal with the realities. Here the purchasing and transferring firm comprise the same interests. The transferor firm consists of the three heads as above mentioned and the eleven women, and the transferee firm consists of the same three heads of the same families, together with the husbands of ten of the ladies (one of the eleven ladies is the wife of one of the three managing members), and three other persons (whose exact relationship has not been made clear) who are also members of one or the other of the three families. Again, bearing in mind the legal incidents of membership of a joint Hindu family, bearing in mind that in substance this is a firm comprised of the members of three Hindu families represented by their heads originally and that all these subsequent changes merely consist in adding names of other members which, so far as we can see, do not in the least alter the share in the profits coming into the various families, or the liabilities of the families, the transfer by the one firm comprising the three heads, the husbands of ten of the said women, and three other members of the family would have no reality at all. It is as though A.B.C. were transferring to A.B.C. This is the view the income tax authorities have taken of the matter, and we think it is the right one. It is this sort of view that would be taken without any assumption that this was an attempt to evade income tax law. It follows directly, once it is seen that this firm is really made up of three joint Hindu families, represented originally by the three managing members, mediately by the same three and a number of female members, and finally by the same three and a number of male members, the later additions making no practical difference.

It follows, in our opinion, that there is no point of law arising which would justify us in calling upon the Income Tax Commissioner to state a case. The application accordingly fails and is dismissed with costs which we fix at Rs. 75.

[IN THE MADRAS HIGH COURT].

MANICKAM CHETTIYAR

v.

INCOME TAX OFFICER, MADURA.

LEACH, C. J., VARADACHARIAR, J., and MOCKETT, J.

December 16, 1937.

INCOME TAX DEBT—PRIORITY—MODE OF RECOVERY—
ASSETS REALISED BY COURT IN EXECUTION OF DECREE AGAINST

ASSESSEE—APPLICATION BY INCOME TAX OFFICER TO COURT FOR PAYMENT OF ARREARS OF INCOME TAX—MAINTAINABILITY—INHERENT POWER OF COURT TO ORDER PAYMENT—INCOME TAX ACT (XI OF 1922), SEC. 46.

In execution of a money decree against a person certain properties belonging to him were attached and brought to sale. The Income Tax Officer who had made an order against him for payment of a certain sum of money as income tax, made an application to the Court, for an order directing payment to him out of the sale proceeds, of the amount of income tax due to the Crown: Held, that the income tax debt had priority and the Court had inherent power to make an order on the application for payment of moneys due to the Crown. Sec. 46 of the Income Tax Act is not exhaustive of the remedies of the Crown to cover arrears of income tax and does not preclude an application of this nature; it is not also necessary for the Crown to obtain a decree against the assessee or to effect an attachment before making such an application.

Cases referred to:

ANANTAPADMANABHASWAMI v. OFFICIAL RECEIVER, SECUNDRABAD [1933] (I.L.R. 56 Mad. 405).

DEPUTY COMMISSIONER OF POLICE v. VEDANTAM [1935] (I.L.R. 59 Mad. 428; 69 M.L.J. 832).

GAYANODA BALA DASSEE v. BUTTO KRISTO BAIRAGEE [1907] (38 Cal. 1040).

HENLEY & Co., *In re* [1879] (9 Ch. D. 469).

KRISHNASWAMY MUDALIAR v. OFFICIAL ASSIGNEE OF MADRAS [1903] (13 M.L.J. 278; I.L.R. 26 Mad. 643).

RAMACHANDRA v. PITCHAIKANNI [1884] (I.L.R. 7 Mad. 434).

SONIRAM RAMESHUR v. MARY PINTO [1934] (1934 I.T.R. 58; I.L.R. 11 Rang. 467).

VARADACHARI v. SECRETARY OF STATE [1936] (I.L.R. 59 Mad. 872).

PETITION under Section 115 of Act V of 1908 and Sec. 107 of the Government of India Act praying the High Court to revise the order of the Court of the District Munsif of Madura Town.

K. Balasubramania Aiyar, for the Petitioners.

N. Sreenivasa Aiyangar for Government Pleader, for the Respondents.

Mr. Justice Varadachariar before whom the case came on for hearing made the following order:

ORDER OF REFERENCE.

VARADACHARIAR, J.—Mr. Balasubramania Aiyar raised two questions before me, in support of this revision petition. On one of them I feel little doubt, but the other point is one of some importance and, notwithstanding the reliance placed on behalf of the Government on the decisions in *Deputy Commissioner of Police v. Vedantam* and *Soneram Rameshur v. Mary Pinto*, I think that it should be considered by a Division Bench or even by a Full Bench if the Chief Justice so directs.

This revision petition arises out of an application made by the Income Tax Officer of Madura South to the District Munsif of Madura Town, purporting to be under Sec. 151, C.P.C., and praying that out of some monies in the custody of that court in the course of the execution of a decree obtained by the present petitioner against the assessee, the arrears of income tax due by the assessee, might be paid in the first instance. Two questions were raised before the lower court on behalf of the present petitioner, viz., (i) whether the Government's claim was entitled to priority and (ii) whether, as a matter of procedure, the petition by the Income Tax Officer to the civil court was sustainable. On both those points the lower court held against the present petitioner and directed payment to the Government in the first instance. Hence this revision petition by the decree-holder.

So far as the priority of Government's claim is concerned, I see no reason to differ from the view taken by the lower court. Mr. Balasubramania Aiyar relied on an expression of doubt in *Ramachandra v. Pitchaikanni* as to the applicability in this country of the English doctrine relating to the priority of the Crown debts; but I think the weight of authority in favour of the recognition of that priority even in this country is so strong that this expression of doubt cannot help the petitioner to any material degree, (Cf. 59 Mad. 428 and *Varadachari v. Secretary of State*, *Gayanoda Bala Dassee v. Butto Kristo Bairagee*, *Soneram Rameshur v. Mary Pinto* and the provisions in the Insolvency Acts relating to the priority of Crown debts).

It is on the question of procedure that I have felt some difficulty. Some of the cases above referred to arose out of applications on behalf of the Government to recover court-fees payable to Government in pauper suits. There is no difficulty in supporting the maintainability of the petition by Government in that class of cases, because the Civil Procedure Code treats the Government as a decree-holder to the extent of the court-fee payable and the ordinary

procedure under the Code is available for the enforcement of that claim. In *Soneram Rameshur v. Mary Pinto* the petition related to the recovery of income-tax, and in that sense the case is directly in point; but though the learned judge gave a ruling in favour of the maintainability of the petition, he also states that the application was not opposed on behalf of the respondents and that they consented to the payment. I am therefore unable to treat that decision as concluding the point. In *Deputy Commissioner of Police v. Vedantam*, CORNISH, J., was dealing with a claim for arrears of motor tax, and relying upon *In Re Henley & Co.*, and on the decision in *Gayanoda Bala Dassee v. Butto Kristo Bairagee* the learned judge held that an application like the present must be treated as maintainable. The 33 Cal. case is not strictly analogous because it related to a claim for court-fee payable to Government in respect of which, as already observed, Government is in the position of a decree-holder. The proposition that the declaration of a first charge on the subject matter of the suit does not preclude the Government from enforcing its claim as a decree-holder in other ways does not throw much light upon the question now raised before me. In *Re Henley & Co.*, no doubt, recognised the right of the Crown to proceed otherwise than in the manner pointed out by the Income-tax Act, but in that case, as the application was made in the course of liquidation proceedings, an application would be the proper form. The Indian Income-tax Act of 1922 makes detailed provisions in Sec. 46 for the recovery of income tax. Certain powers are given to the Collector and certain powers are given to the Income Tax Officer. I make no further reference to the provision relating to the Collector's power because no application has been made in the present case by the Collector and the Act does not expect him to make an application but to exercise certain powers of his own. The Income Tax Officer is authorised under certain conditions to adopt the procedure available for the collection of arrears of municipal tax or local rate. Provision is also made in sub-clause (5) for a requisition to persons paying salaries to assesseees. It is a matter requiring consideration whether in view of these detailed provisions having been made by the statute itself for the recovery of assessment, it is permissible to recognise in addition an application to the ordinary civil court which must *prima facie* be regarded as dealing only with the rights of litigants in the ordinary civil court. It may be that arrears of income-tax can be made the subject matter of a regular suit as a Crown debt; but whether an application under Section 151, C.

P. C. or under any general principle of law was at all contemplated by the Income Tax Act or by the provisions of the C.P.C. is a matter about which I entertain grave doubts, notwithstanding the respectful attention that I have given to the cases to which I have already referred. It is this point that I should like to be heard and decided authoritatively by a Bench subject to the order of the Chief Justice. The decision in C.M.P. 2083 of 1933 affords me no guidance because there was in that case distraint order issued by the Tahsildar under the provisions of the Revenue Recovery Act."

The case was heard by a Full Bench.

JUDGMENT.

LEACH, C. J.—The petitioner obtained a money decree against one Govinda Rao and in execution thereof attached certain moveable properties belonging to the judgment debtor and brought them to sale. Govinda Rao under an order of assessment dated the 28th August 1934 was required to pay a sum of Rs. 301-13-0 by way of income-tax. He did not comply with the notice of demand for payment and on the 12th November 1934 a penalty of Rs. 10 was imposed by the Income Tax Officer because of the default, thus increasing the total amount due by the assessee to Rs. 311-13-0. Before the sale the Income Tax Officer filed an application in court asking for an order directing the payment out to him from the sale proceeds when the sale took place of the amount due to government by Govinda Rao. The sale in execution was in due course carried out but only realised Rs. 227-9-0. After reserving the amount required for the costs of execution, the District Munsif ordered the balance to be paid out to the Income Tax Officer. The question which we are called upon to decide is whether the court had power to order the payment out of moneys due to government on mere application.

I had occasion to consider this question in the case of *Sone-ram Rameshur v. Mary Pinto* when sitting as a judge of the Rangoon High Court, and, following the decision of SALE, J., in *Gayanodabala Dassee v. Butto Kristo Bairagee*, held that inasmuch as the Crown has priority over unsecured creditors in the payment of debts the court can, on application and without a formal attachment being issued, order the payment of a Crown debt due by the debtor where there are funds in court belonging to the debtor. The District Munsif referred to this decision in his order. The order which I passed in that case was passed by

consent, and the only arguments were those addressed to the court on behalf of the Crown, but the question has been fully argued before us to-day and I see no reason for changing the opinion there expressed.

It has been suggested that inasmuch as Section 46 of the Indian Income Tax Act provides modes for the recovery of arrears of income tax the Crown is not entitled to adopt any different method. Sub-section (2) states that the Income Tax Officer may forward to the Collector a certificate under his signature specifying the amount of arrears due from an assessee, and the Collector, on receipt of such certificate, shall proceed to recover from the assessee the amount specified as if it were an arrear of land revenue. Without prejudice to any powers of the Collector in this behalf he shall for the purpose of recovering the amount have in respect of the attachment and sale of debts due to the assessee the powers which under the Code, a civil court has in respect of attachment and sale of debts due to a judgment debtor for the purpose of the recovery of an amount due under a decree. By Sub-section (3) it is provided that in any area in respect of which the Commissioner has directed that any arrears may be recovered by any process enforceable for the recovery of an arrear of any municipal tax or local rate imposed under any enactment for the time being in force in any part of the province, the Income Tax Officer may proceed to recover the amount due by such process. Under Sub-section (5) if any assessee is in receipt of income chargeable under the head "salaries" the Income Tax Officer may require the employer to deduct from his salary what is due by way of income-tax. This section, however, does not profess to be exhaustive and it cannot without express words to that effect take away from the Crown the right of enforcing payment by any other method open to it. Therefore I do not regard Section 46 as imposing a bar to an application of the nature of the one we are now concerned with.

The learned advocate for the petitioner then contends that as a private person cannot enforce payment without first obtaining a decree the Crown is in the same position. The argument is that a private person is governed by the provisions of the Civil Procedure Code and as there is nothing in the Code which places the Crown in a different position the procedure there contemplated must be followed. I am unable to agree. This argument ignores the special position of the Crown, the special circumstances and the court's inherent powers. It cannot be denied that the Crown had the right of priority in payment of debts due to it. It is a right which

has always existed and has been repeatedly recognised in India. If the Crown is entitled, as it is, to prior payment over all unsecured creditors the position of secured creditors does not arise. I see no reason why the Crown should not be allowed to apply to the court for an order directing its debt to be paid out of money in court belonging to the debtor, without having to file a suit. Of course it must be a debt which is not disputed or is indisputable. In this case the debt represents money due to the Crown under the Income Tax Act and the demand of the Income Tax Officer is not open to question.

What would be the effect if the Crown were not able to apply to the Court for the withdrawal of the money in a case like this? According to the argument it would mean that the Crown would have to file a suit against the debtor and the opposing creditor and then obtain an interim injunction preventing the money from being withdrawn from court pending the decision of the suit. When the suit comes on for hearing the court would be bound to decree it. Therefore there would be not only a great waste of the time of the parties and of the court, but the opposing creditor would run the danger of being mulcted in costs.

The court must pay money in its hands out to the person entitled to it. If the court were asked to pay out money to *A* with the certain knowledge that the money belonged to *B* it would naturally decline to do so and would make sure that *B* got it. Here, the Crown is entitled to the money in Court—there is no question about this—and asks the court to pay it out. The right to payment being indisputable, justice requires that it should be paid out to the Crown and formal application for payment has been made. It seems to me that both right and convenience demand that the court should exercise its inherent power.

At one stage the learned advocate for the petitioner suggested that the attachment having taken place the petitioner was in the position of a secured creditor. This argument is not open to him in view of the decision of a Full Bench of this court in *Krishnaswami Mudaliar v. Official Assignee of Madras*. He did suggest that this decision had been overruled by the Judicial Committee in *Gummidelli Anantapadmanabhaswami v. Official Receiver of Secunderabad*, but it is clear from a perusal of the report that their Lordships there refused to go into the question and reserved their decision for a future occasion. Consequently we have got to accept the decision in *Krishnaswamy Mudaliar v. Official Assignee of*

Madras as stating the law correctly; and the petitioner is not in the position of a secured creditor.

The learned advocate for the petitioner has also argued that unless there is some statute which expressly authorises a petition of this nature the petition cannot be maintained. I have in effect already dealt with this question and it follows from what I have said that I do not consider that a special Act of the legislature is required to enable the Crown to apply to the court for payment out of money to which it has an undoubted right.

In the case of the *Deputy Commissioner of Police, Madras v. Vedantam*, Cornish, J., took the same view. There money was due to the Crown as arrears of tax under the Motor Vehicles Taxation Act. The learned judge also relied on the judgment of Sale, J., in *Gayanoda Bala Dassee v. Butto Kristo Bairagee*.

For these reasons I am of the opinion that the District Munsif came to the correct conclusion and his order should not be disturbed. The petition will be dismissed with costs.

VARADACHARIAR, J.—My doubts have been indicated in the order of reference. I am not able to say that they have been wholly dispelled. They are, however, not serious enough to warrant my dissenting from the conclusion which my Lord and my learned brother have reached on what is after all a question of procedure. Even when making the reference I felt no doubt as to the right of the Crown to priority. I may add that the balance of convenience certainly seems to be in favour of the view indicated in the judgment just delivered. I, therefore, agree with the order dismissing the petition with costs.

MOCKETT, J.—I agree with my Lord the Chief Justice. It must be remembered that the court holds the money for the purpose of paying it to the person entitled to it, and in this Presidency so long as the decision in *Krishnaswamy Mudaliar v. Official Assignee of Madras* is law, as it undoubtedly still is, there is no difficulty with regard to third parties claiming prior rights by way of attachment. The position being so, this case does not seem to present any difficulty. As a matter of expediency it is obvious that the course adopted here is the better. The alternative seems to be this, as has been pointed out by my Lord the Chief Justice, a suit is filed with regard to a matter which the defendant cannot contest and the only result is that there is delay and unnecessary expenditure for the parties. What happens under the present procedure? Here is this money lying in court for the purpose of being paid out to the person who is entitled to receive it. The Crown

goes to the court and says, "Here is a debt which is due to me about which there can be no dispute." I consider that under those circumstances the court can rightly invoke its power under Sec. 151, C.P.C., in making the payment to the person entitled to it. Cornish, J., in the case to which my Lord has referred, *Deputy Commissioner of Police, Madras v. Vedantam*, draws attention to a decision from which I have derived assistance, *In Re Henley & Co.* In that case a Bench consisting of James, Brett and Cotton, L. JJ., emphasised that the fact that a remedy is given by a statute for the recovery of a debt due to the Crown in no way takes away the right of the Crown to invoke other methods if it thinks fit.

I agree that the decision of the court below is right and that this petition should be dismissed with costs.

Petition dismissed.

[IN THE HOUSE OF LORDS].

MOSS EMPIRES LTD.

v.

INLAND REVENUE COMMISSIONERS.

LORD ATKIN, LORD THANKERTON, LORD MACMILLAN, LORD
WRIGHT, LORD MAUGHAM.

June 24, 1937.

AGREEMENT—COMPANY GUARANTEED PAYMENT OF DIVIDENDS OF ANOTHER COMPANY FOR FIVE YEARS—COMPANY PROVIDING NET SUMS REQUIRED FOR PAYMENT OF DIVIDENDS AT A FIXED RATE, LESS TAX—SUMS SO PROVIDED TREATED BY GUARANTORS AS A TRADE EXPENSE IN COMPUTATION OF PROFITS—INCOME TAX—"ANNUAL PAYMENTS CHARGED WITH TAX UNDER SCHEDULE D."—"NOT WHOLLY PAYABLE OUT OF PROFITS OR GAINS BROUGHT INTO CHARGE".—INCOME TAX ACT 1918 (8 & 9 Geo. 5. c. 40), SCHED. D, CASE III, R. 1 (a), ALL SCHEDULES RULES, R. 21—FINANCE ACT, 1927 (17 & 18 Geo. 5, c. 10), Sec. 26.

The appellant company guaranteed the payment of a fixed dividend of 7½ per cent (less income tax) for each of the first five financial years on the ordinary shares of another company. Sums were paid to meet the dividends each of the five years, and in each of those years, the appellants in computing the amounts of their profits and gains for tax purposes, were permitted to deduct the sum

paid under the agreement, as being a disbursement or expense wholly laid out for the purposes of their trade. Consequently the payments were not "payable out of profits or gains brought into charge" and thus satisfied one of the conditions of the applicability of rule 21 of the All Schedules Rules of the Income tax Act 1918. For the first five years assessments were made in respect of the sums paid by the appellants under the agreement. At the request of the appellants the Special Commissioners stated the following questions for the opinion of the Court: Whether the sums payable under the guarantee by the appellants were annual payments from which income tax was deductible and, if so whether the appellants were correctly assessed under rule 21 of the General Rules amended by the Finance Act 1927, Sec. 26; Held, that the sums so provided annually were annual payments charged with tax under Schedule D and, it being admitted that they were not payable out of profits or gains brought into charge, the guarantors were bound to deduct and account for the income tax thereon. The annual payments made had the necessary quality of recurrence and were within the terms of rule 21.

Interlocutor of the First Division of Court of Session (1916) S.C. 531) *affirmed*.

Case referred to :

MARTIN v. LOWRY [1926] (96 L.J.K.B. 379 : (1927) A.C. 312).

The facts are stated in the judgment of Lord Macmillan.

The arguments were heard on June 1 and sufficiently appear in the judgment of Lord Macmillan.

Latter, K. C., and R.H.S Calver (of the Scottish Bar), for the appellant Company.

J. R. Wardlaw Burnet (K. C., of the Scottish Bar) *R. P. Hills* and *T. B. Simpson* (of the Scottish Bar), for the respondents.

LORD ATKIN.—My Lords, I have had the advantage of being able to read in advance the opinion which is about to be delivered by my noble and learned friend Lord Macmillan. I entirely agree with it and I have nothing to add.

LORD THANKERTON.—My Lords, I have had the same privilege of considering the opinion about to be delivered by my noble and learned friend Lord Macmillan and also an opinion about to be delivered by my noble and learned friend Lord Maugham.

LORD MACMILLAN.—The question is whether certain payments made by the appellants in fulfilment of an obligation undertaken by them in an agreement dated January 31, 1928, were

"annual payments" charged with tax under Schedule D within the meaning of paragraph 1 of rule 21 of the General Rules applicable to all schedules of the Income tax Act, 1918. If so, then it was the duty of the appellants under the rule on making the payments to deduct therefrom income tax at the current rate and to account to the Commissioners of Inland Revenue for the tax so deducted.

The parties to the agreement in question were (1) the appellants and Theatre Royal Drury Lane, Ltd., thereafter called "the guarantors" (2) two named gentlemen on behalf of themselves and all other holders of ordinary shares in Dominion Theatre Ltd., thereafter called "the trustees" and (3) Dominion Theatre Ltd., thereafter called the "Company". It is unnecessary to detail the circumstances which led up to the agreement or the business reasons which induced the parties to enter into it. In the recitals it is stated that the holders of the ordinary shares of Dominion Theatre Ltd., were entitled to receive a fixed preferential dividend at the rate of $7\frac{1}{2}$ per cent per annum on the capital paid up thereon out of the profits of the company available for distribution and determined to be distributed by way of dividend. The purpose of the agreement was to ensure the payment of this return on the ordinary shares for five years, and with this object the appellants and Theatre Royal Drury Lane Ltd., jointly and severally guaranteed and covenanted to and with the trustees, as trustees for and on behalf of the holders for the time being and from time to time of the said 250,000 ordinary shares of the Company, "that in case the profits which may be available for distribution as dividend as aforesaid on the said 250,000 ordinary shares of the company shall be insufficient to pay the said fixed dividend at the rate of $7\frac{1}{2}$ per cent (less income tax at the current rate) for each of the first five financial years of the Company ending on the 30th day of January 1933, the guarantors will make up and pay to the trustees in respect of each and every such five years a sum equivalent to the amount by which the profits available as aforesaid shall fall short of the sum required to pay the aforesaid dividend (less tax for any year during the said period of five years) or in case there shall be no profits available for distribution as aforesaid in respect of any of such years then the guarantors will pay to the trustees a sum equivalent to the sum required to pay the fixed dividend at the rate of $7\frac{1}{2}$ per cent per annum (less tax) on such ordinary shares for that year. Provided and it is hereby declared that in such last mentioned event the liability of the guarantors

shall be limited to a sum equivalent to the sum which would have been payable by way of fixed dividend at the rate of $7\frac{1}{2}$ per cent. per annum on the ordinary shares for that year if there had been profit of the company available for distribution in respect thereof.

Clauses followed providing that all sums paid by the guarantors should be distributed by the trustees or by the company amongst the ordinary shareholders in the same proportions as if they were distributions by way of fixed dividend that any sums so distributed were to be deemed to be *pro tanto* payment and satisfaction of the $7\frac{1}{2}$ per cent. dividend; and that in case in any year the profits available for distribution should not be sufficient to pay the $7\frac{1}{2}$ per cent. dividend the company should notify the guarantors of the sum "required to make up the said fixed dividend to $7\frac{1}{2}$ per cent. per annum (less tax) or to pay the said fixed dividend".

In each of the five years covered by the agreement the appellants were called upon to make payments under their obligation. In some of the years the company made no profits, in others the profits made were insufficient to pay the $7\frac{1}{2}$ per cent dividend in full. The sums so paid by the appellants (as now adjusted) were as follows (shillings and pence discarded):

	£.
1929 ...	... 3,322.
1930 ...	... 7,438.
1931 ...	... 1,655.
1932 ...	... 6,797.
1933 ...	... 7,031.

It is to be noted that the sum which the appellants paid in each case was their share of the amount less tax required for the payment of the $7\frac{1}{2}$ per cent. Thus in the last instance where the company made no profits the sum of £ 7,031 which the appellants were called upon to pay was calculated as follows:

	£.	s.
350,000 Ordinary shares at $7\frac{1}{2}$ per cent	18,750	0
Less tax at 5s. per £.	4,687	10
	<hr/>	
	14,062	10
Whereof one half.	7,031	5
	<hr/>	

In each of the five years the appellants in computing the amount of their profits and gains for tax purposes, were permitted to deduct the sum paid under the agreement as being a

disbursement or expense wholly and exclusively laid out or expended for the purposes of their trade. Consequently the payments were not "payable out of profits or gains brought into charge" and thus satisfied one of the conditions of the applicability of rule 21.

The sums paid by the appellants and their co-obligants were duly utilised in paying to the ordinary shareholders a return of 7½ per cent. less tax on their shares. In at least two instances dividend warrants in ordinary form were sent out by the company to the shareholders with the usual certificate that income-tax had been deducted and had been or would be duly accounted for to the proper officer.

For the five fiscal years 1928-29 to 1933-34 assessments were made in respect of the sums paid by the appellants under the agreement. The appellants appealed to the Special Commissioners who affirmed the assessments and at the appellants' request stated for the opinion of the Court the two following questions: (1) Whether the sum payable under the said guarantee by the appellant company were annual payments from which income-tax was deductible and, if so, (2) Whether the appellant company was correctly assessed under rule 21 of the said General Rules as amended by the Finance Act 1927, Section 26". The First Division of the Court of Session (Lord Moncreiff dissenting) answered both questions in the affirmative.

At your Lordships' bar it was argued for the appellants that the payments were not annual payments inasmuch as they were casual, independent, not necessarily recurrent and throughout subject to a contingency. This argument commended itself to Lord Moncreiff, but I am unable to accept it. There was a continuing obligation extending over each and all of the five years to make a payment to the trustees for the shareholders in the event of the company earning no profits or insufficient profits. The fact that the payments were contingent and variable in amount does not affect the character of the payments as annual payments. Rule 21 is not primarily a charging section but is part of the machinery of collection. The charging enactment is to be found in rule 1 of Case III, Schedule D, whereby tax is imposed on "any interest of money whether yearly or otherwise or any annuity or any other annual payment.....payable.....as a personal debt or obligation by virtue of any contract". I am of opinion that the payments in question fall within these words.

Appellants' counsel sought to argue contrary to the admission recorded in the Lord President's opinion—that the sums paid were

not payments of income, inasmuch as they were payments made in lieu of income or by way of compensation for not receiving income, but I am quite unable to accept this view. The payments were indisputably income in the hands of the recipients.

There was some discussion as to the correct interpretation of the obligation undertaken by the appellants. Was it to pay one half of the gross sum required to pay or make up the dividend with the right (and duty) to deduct the tax when making payment? Or was it to pay one-half of the net sum required to pay or make up the dividend after deduction of tax? To take the last year as an illustration—Was the obligation to pay one half of £ 18,750 with the right to deduct tax or was the obligation to pay one half of £ 14,062. It is unnecessary to determine this point, for, whichever be the true reading the appellants were, in my opinion, bound when making payment on either basis to deduct and account for tax. It may, however, be pointed out that on the first basis the sums allowed to be deducted by the appellants as disbursements, as also the sums assessed, would have been different from those actually allowed and assessed: while on the second basis the agreement would not achieve its purpose, for the payments, if the appellants retained out of them the tax payable, would not be sufficient to put the company in funds to make a distribution of $7\frac{1}{2}$ per cent. less tax among the shareholders.

Being of opinion, as I am, that the payments in question were "annual payments charged with the tax under Schedule D" and it being admitted that they were not "payable out of profits or gains brought into charge", I move your Lordships to affirm the interlocutor of the First Division of the Court of Session and dismiss the appeal with costs.

LORD WRIGHT.—My Lords, I agree with the opinion which has just been delivered by my noble and learned friend Lord Macmillan. I have also had the advantage of reading in print the opinion about to be delivered by my noble and learned friend Lord Maugham, in which I also concur.

LORD MAUGHAM.—I have had the advantage of reading the opinion of my noble and learned friend Lord Macmillan, with which I entirely concur. I will only add for myself some brief observations. The sole difficulty in the case, as I see it, is the question whether sums paid under the agreement of January 31, 1928, were "annual payments" within the language of rule 21, of the General Rules of the Income Tax Act 1918. The sentence runs "Upon payment of any interest of money, annuity or other annual pay-

ment etc., and the charging section is to be found in Schedule D, 1, (b) taken with the words of rule 1 applicable to Case III of that schedule as stated by my Lord.

It is, I think to be noted that we are not concerned here with the case of annual profits or gains arising from a trade as to which the decision in *Martin v. Lowry* would be decisive to show that in that context "annual" means "in any one year". In rule 21, "annual" must be taken to have, like interest on money or an annuity, the quality of being recurrent or being capable of recurrence. The payments we are concerned with were to continue for five years, subject to their being required to make up the guaranteed annual dividend, and were plainly payments intended to supplement so far as necessary, the income of the recipients during each of the years in question. In these circumstances, I am of opinion that they had the necessary quality of recurrence and are within the terms of rule 21. In so deciding I apprehend that your Lordships are not travelling in any way beyond the existing decisions with regard to "annual payment" in that rule. On the other point I cannot usefully add anything to what has fallen from my noble and learned friend.

LORD ATKIN.—My Lords, I ought to add that I also agree with the opinion which has just been delivered by my noble and learned friend Lord Maugham.

Application dismissed.

[IN THE RANGOON HIGH COURT].

COMMISSIONER OF INCOME TAX, BURMA

v.

N. S. A. R. CONCERN.

SIR GOODMAN ROBERTS, C.J., MYA BU, J. and DUNKLEY, J.

February 3, 1938.

BUSINESS EXPENDITURE—MONEY-LENDING BUSINESS—INCOME COMPRISING NON-TAXABLE AGRICULTURAL RECEIPTS—EXPENDITURE FOR EARNING SUCH RECEIPTS, WHETHER ALLOWABLE—ENGLISH AND INDIAN LAW—DIFFERENCES—INDIAN INCOME TAX ACT (XI OF 1922), Secs. 4 (3) (viii) and 10 (2) (ix).

Where an assessee's income from business comprises both agricultural income which is exempt from tax and other taxable income, the assessee is not entitled under Sec. 10 (2) (ix) of the Income-tax

Act to deduct from such taxable income the expenditure incurred for the purpose of earning the agricultural income.

S. A. S. S. Chellappa Chettiar's Case (1937 I.T.R. 97) dissented from. *Hughes v. Bank of New Zealand* (1936, 3 All. E.R. 975) distinguished.

Cases referred to :

CHELLAPPA CHETTIAR, S. A. S. S. v. COMMISSIONER OF INCOME TAX, MADRAS [1937] (I.L.R. 1937 M. 734 ; 1937 I.T.R. 97).

HUGHES v. BANK OF NEW ZEALAND [1936] (3 All. E.R. 975).

MAHARAJA OF DARBHANGA'S CASE [1935] (I.L.R. 14 Pat. 623 ; 1935 I.T.R. 135).

PROVIDENT INVESTMENT CO., LTD. v. COMMISSIONER OF INCOME TAX, BOMBAY [1932] (6 I.T.C. 21)

SOMASUNDARAM CHETTIAR v. COMMISSIONER OF INCOME TAX [1928] (2 I.T.C. 505 ; 54 M.L.J. 436 ; A.I.R. 1928 Mad. 487).

Case stated by the Commissioner of Income Tax, Burma, under Sec. 66 (2) of the Income Tax Act.

The Commissioner's statement of case was as follows :—

CASE.

" Case stated under Sec. 66 (2) of the Income Tax Act, of question of law arising from the appeal of the assessee styled " N.S.A.R. " (Hindu Undivided Family), against their assessment for the year 1936-37 ".

The assessee has required reference of the questions copied in Annexure A.

The question which I refer as presenting the material contest in law is :—

" The assessee having a business which comprises both " agricultural " and other receipts, is he entitled under Sec. 10 (2) (ix) of the Act to deduction of all expenditure (including that incurred for the special purpose of realising the agricultural receipts), after exclusion of the gross agricultural rents in accordance with Sec. 4 (3) (viii) and 2 (1) (a) ? "

2. **Statement of facts.**—The assessee is a Chettyar Family engaged in the usual type of Chettyar money-lending business mainly at Toungoo, Ela, Yedashe and Oktwin in Burma. In the course of that business, a very large part of their loans proved unrealizable in cash ; and lands, etc., have been taken over to a large extent from defaulting debtors, and these are held (so far as appears) pending opportunity for satisfactory realisations by sale. Meantime, rents are received therefrom.

3. The exact particulars of account are intricate, by reason of the usual methods of Chettyar accounting, the inter-connections of the branches, and adjustments made for income-tax purposes. There is neither a Balance Sheet, nor *complete* Profit and Loss accounts (separate or consolidated). The returned particulars for each "Agency" comprise on the one side only the "Non-agricultural" receipts; and on the other, all expenses (other than certain special items such as Land Revenue which seem to have been taken direct into the unreturned "Agricultural" account). Various "adjustments" of the figures were then appended, to bring the nett difference-figures into line with the standard income-tax treatment; and these comprised *inter alia* "add-backs" for the reduction of the expense-deduction figures, by amounts purporting to be the estimated parts of establishment costs attributable to the agricultural activities.

These latter exclusions, which totalled Rs. 5,500 were increased by Rs. 9,719 on re-estimation by the Income tax Officer.

By the time the assessment order was passed, however, the assessee had seen the Madras decision in *S.A.S.S. Chellappa Chettyar* (1937 I.T.R. 97); and appealed on its decided principle, (but only in respect of the Income tax Officer's *further* exclusions), thus:—

"Your petitioner objects to the following add-backs made by the Income tax Officer:—

Charges for supervision of lands further disallowed:—

Toungoo	... Rs.	2,784
Ela	... "	850
Yedashe	... "	1,585
Oktwin	... "	4,500
Total	...	9,719

Your petitioner begs to submit that the lands form part of the assets of your petitioner's business and all expenses incurred in managing and supervising the same ought to be allowed under Sec. 10 (2) of the Act. Your petitioner begs to refer to the recent Madras High Court decision in the matter of *S. A. S. S. Chellappa Chettyar*.

Wherefore your petitioner prays that the assessable income may kindly be reduced by Rs. 9,719 and the assessment modified accordingly."

4. By the appellate order copied as Annexure B, the Assistant Commissioner reduced the estimation-addition to Rs. 6,924 : but negatived the claim in law that no exclusion of any kind should be made.

There is no contest before me as to the proper attribution amounts, in themselves.

The nett assessment as reduced in appeal is Rs. 26,961 (Total Income).

5. No other details of account appear to be required for the purposes of this statement ; but I annex (C) certain extracted details which may give a more concrete general picture of the business.

6. **Opinion of the Commissioner.**—I do not think (with respect) that *S. A. S. S. Chellappa* was rightly decided ; but I conceive that the crux lies rather in distinguishing the very weighty and quite unquestionable United Kingdom decision cited therein, *Hughes v. Bank of New Zealand* (15 A.T.C. 244 and 540).

In that case, a non-resident had a branch "trading in London and the branch received certain interest income, as to which there were certain exemptions applicable for the case of a non-resident. The Crown sought nevertheless to raise tax, on the ground that because the items were part of the London "Trade" receipts, they should still come into charge under the "trading" case of Schedule D, despite those exemptions standing within other Schedules and cases. Failing in that contention, it was then claimed for the Crown that the corresponding expenditure (comprising both interest on borrowed capital and share of establishment expenditure) should be attributable accordingly, and only the nett amounts be held exempt—or to put it in another aspect, that only the expenditure attributable to taxable income receipts should be treated as expenses of the chargeable business. This also was negatived.

7. The exact specialities of that decision need to be compared. Three respective exemption clauses were in issue and they were :

Section 46.—"Securities.....with a condition that the interest thereon shall *not be liable to tax*.....shall be exempt accordingly."

Schedule C, General Rule 2 : "No tax shall be chargeable in respect of the Interest....."

Schedule D. Miscellaneous Rule 7 : "All the provisions of Schedule C.....shall extend to the tax to be assessed and charged under this rule."

The comparable clauses in our present issue are:—

Section 4 (3) (viii): “This Act shall not apply to agricultural income.”

Section 2 (1): “Agricultural income” means any rent or revenue derived from land which is used for agricultural purposes and is either assessed to land revenue in British India or.....etc.”

The expense-deduction clause in issue in the United Kingdom case was:—

Schedule D, Cases I and II, Rule 3: (per M.R.)—“That is put in negative form, but it is generally, and I think correctly, treated as being capable of being turned back into positive enactment with the result that it provides that ‘money wholly and exclusively laid out or expended for the purposes of the trade’ may be deducted.”

Our comparable clause is:—

Section 6: “Save as otherwise provided by this Act, the following heads of income, profits and gains, shall be chargeable to income tax in the manner hereinafter appearing, namely.....(iv) Business.....”

Sec. 10 (1)—“The tax shall be payable by an assessee under the head “Business” in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely.....(iii) in respect of capital borrowed for the purposes of *the business*.....the amount of the interest paid.....(ix) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning *such* profits or gains”.

8. The Court of Appeal held that the exemption-clauses were effective (on all the three groups of items in issue).

As to the expense-deduction, it was taken on the footing that it was ‘all one business (which as below I accept as applicable here). The Master of the Rolls said, “If I had been able to find a warrant for giving effect to (the Crown claim) in the language of the Act, I should certainly have done so, because it seems to me to be both a reasonable and a proper conclusion”. But after distinguishing cases as to “several” trades or activities, it was concluded here that there being only one trade, all the enacted expenses of the trade must on the terms of the statute be deducted from its chargeable receipts (only).

9. Certain subsidiary clauses of our Act may perhaps be referred to.

Section 59 empowers the making of Rules to:—

“Prescribe the manner in which the income, profits and gains shall be arrived at in the case of incomes derived in part from agriculture and in part from business.

Rule 23 prescribes a treatment where agricultural produce is manufactured before sale—providing that “an assessee shall be entitled to deduct from *such* (business) income,” the market value of that produce and not his actual expenses in producing it.

Rule 24 provides an arbitrary determination in respect of Tea production and manufacture, *viz.*, that the whole shall be computed “as if it were” business, and 40 per cent. of the net amount shall be “deemed to be income liable to tax.

Attention should perhaps also be drawn to certain departmental instructions in paragraphs 39 (ix—xi) of the Mannual, relative to tax-free securities: even though it is to be noted that this is a different matter fundamentally.

10. In *I.L.R. XIV Rangoon 758*, it was held by DUNKLEY, J., that “the leasing out of agricultural land to tenants and making advances” was “carrying on a business.” 3 I.T.C. 378, and Note 8 of the prescribed Return-form may be referred to. Despite the vague implication to the contrary in some of the clauses cited above, I have no hesitation in accepting the series of Madras decisions concluding that all the activities of a person in the position of this assessee are Business, and one Business. Some aspects of those activities may come to be *chargeable* under a prior specific Section of the Act and not its Section 10, but that is only the position described by ATKIN, L.J., at page 318 of 15 T.C. (*Salisbury House*).

11. By its Section 4, the *applicability* of our Act (*i.e.*, to income: “though the tax is necessarily a tax upon persons, and only “in respect of” their income) is more or less confined to income within the jurisdiction. It has always been held that foreign net losses—and *a fortiori* foreign expenses in detachment from the sectional local profits—are not deductible from the business that is within the jurisdiction. It will be enough to cite 6 I.T.C. 21.

There are very considerable cases where the foreign activities are part of one business extending within the jurisdiction. I do not see how the present assessee’s claim can be upheld without entailing consequentially the manifestly unreasonable reversal of those decisions. It would mean too, that (despite the limited allowance in Section 10 (2) (viii) far more than these assessee have

ever thought of claiming will come in to wipe out their money-lending profits—all their Land Revenue.

12. I do not think this totally unreasonable state of affairs does appertain. *A part* of something can very well lie outside the Act. Section 10 can only relate to what lies within it, the remaining part. That and that alone is the particular Business in consideration; and it is only the profits of that part of the whole business that are to be computed after allowances which in this particular regard are specifically restricted to expenditure for purpose of *such* profits. That basis was expressly applied in 5 I.T.C. 396 (salary of a receiver of a partly agricultural estate) *Agra Spinning and Weaving*, 24th November 1933 expenses of liquidators in part engaged on winding up and partly on running business and 9 I.T.C. 128 (P.C.) receipts partly 'foreign' and partly 'mutual' and partly chargeable.

13. The difference from the English case is that we are not dealing with an *exemption* from tax as such (like that on tax-free securities); but a complete exclusion from applicability of the Act.

Perhaps on a casuistically literal version, none of the expenditure in such a business would be "solely" for the purposes within the Statute. But it is never sought to construe the section so literally; and as in 5 I.T.C. 396 and in *Ghosh's Executors* (Calcutta, 3rd March 1936) and more or less comparably 5 I.T.C. 188 a sensible determination is made of the portion to be taken as "solely" attributable. *Conville and Conville* (Lahore, 6th February 1936) is relied upon.

14. One may imagine that it was probably not advisedly that in the exclusion of agricultural "income", the legislature comprised *net* income from agriculture, etc., yet actual rents (gross) of a landlord. ("Income" *simpliciter* means net income 1 I.T.C. 11, 24, 76, 345; and Privy Council in 9 I.T.C. 182). This may for certain purposes leave complications; and I think it very markedly does so in regard to deduction of interest on borrowed capital if the whole net income fell to be determined and analysed into agricultural and non-agricultural elements for the purpose of an exemption, the situation in that particular regard would be very different.

But still, on the actual words which the legislature has employed, I have no doubt that the *expenses* left in consideration under the Allowance clause (ix) are only those for the purposes of "such business" as is left within the applicability of the Act. The expenses on the realising of rents are for the purposes only of that part of the business which is taken out of the applicability of the Act.

15. It will be convenient to record (for comparison) my view of the position as to Interest (which has actually been allowed in full, in agreement with the S.A.S.S. decision on that point). The assumption of fact is that the lands are held for realization as soon as a favourable opportunity arises. In 9 I.T.C. 82, your Lordships held (and I respectfully agree) that any difference on such realisation against brought-in "cost" is in such circumstances accountable in the money-lending business. The assumption thus is that the lands are held, and correspondingly the capital invested, towards avoiding accountable loss in this accountable business. The capital is therefore used for the purposes of this detail of the business: even though it be *also* "used" incidentally for the agricultural purpose as well.

I need not consider what the position will be either as to the principal valuation, or current interest charge apportionment in any instance where the retention of the land may be found to be solely with intention of landlordism. But I should apply 2 I.T.C. 505 and the "discontinued business" cases, for the view that Section 10 (2) (iii) does not extend to capital initially borrowed but no longer standing borrowed for the purposes of the charged part of business (*i.e.*, used therefor). I hope that before such cases arise here the legislature will have clarified the definition of Agricultural Income on lines suggested by paragraph 14 above, and I await Your Lordships' decision upon the existing provisions, for my assistance in proposing such a clarification.

16. I ought perhaps to comment further upon the *S.A.S.S.* judgment, in its present applicability.

It did not expressly deal with the wording of Section 10 (2) (ix), but stated that "admittedly" decision on that matter followed from that on sub-section (iii). Not only does the wording and its consequence differ substantially, actually in course of dismissing 5 I.T.C. 397 this difference was expressly relied upon.

The judgment also derives an argument from the view that Land Revenue is an equivalent tax. Doubtless that taxation was the occasion for the present exclusion in issue: but I am unable to see what interpretative relevance that has. An agriculturist without chargeable income gets no relief in respect of these expenses. And certain classes of business which carry an enormously greater burden of other taxation (such as excise licences, or salt-manufacture) do not get any income-tax relief whatever.

17. In my opinion the answer to the question referred is in the negative.

Reference made by the Commissioner of Income Tax, Burma under Section 66 (2) of the Burma Income Tax Act, 1922.

A. Eggar for the Commissioner.

Clark with *Mootham* for the Assessee.

JUDGMENT.

DUNKLEY, J.—In this reference under the provisions of Sec. 66 (2) of the Burma Income Tax Act, the question referred for our decision by the Commissioner of Income Tax, Burma, is as follows:—

“The assessee having a business which comprises both agricultural and other receipts, is he entitled under Sec. 10 (2) (ix) of the Act to deduction of all expenditure (including that incurred for the special purpose of realising the agricultural receipts) after exclusion of the gross agricultural rents in accordance with Secs. 4 (3) (viii) and 2 (1) (a)?”

The material facts can be briefly stated. The assessees, N.S. A.R. Chettiar, a Hindu undivided family business, carry on the usual type of Chettyar banking business at various places in Burma. In the course of that business, they have taken over, in satisfaction of otherwise unrealisable debts, considerable areas of agricultural land, and having become the owners of this land, they lease it annually to tenants and receive as part of the profits of their business the rents realised from the tenants in respect thereof. The income tax return of the business for the 1936-37 assessment showed on the credit side only the “non-agricultural” receipts, the rents and profits of the agricultural land owned by them being left out of account; but on the debit side all expenses (except land revenue) were entered. The assessees themselves, in their return, deducted from the gross expenses a sum of Rs. 5,500 as being that portion of their expenses which was attributable to the expenses of realising the agricultural income. The Income Tax Officer increased the amount of this deduction by Rs. 9,719 and thereupon the assessee appealed to the Assistant Commissioner of Income Tax against this decision of the Income Tax Officer. Meanwhile they had been provided with a new ground of objection by the decision of the High Court of Madras in *S. A. S. S. Chellappa Chettiar v. Commissioner of Income Tax, Madras* (1937 I. T. R. 97) and relying on this decision they contended that no part of the sum of Rs. 9,719 ought to have been disallowed; in fact, it was part of their contention that they were in error in themselves making the original deduction of Rs. 5,500. The Assistant Commissioner of Income Tax overruled this contention, but on a consideration of the facts he reduced the deduction from gross expenses made by the Income Tax Officer by a sum of Rs. 2,795. The question of law now before us for decision is whether, when the income of a business consists partly of rents and profits derived from agricultural land and partly

of receipts from other taxable sources, income tax shall be payable only on the taxable receipts less the gross expenditure incurred in carrying on the whole business, including the expenditure incurred in carrying on that part of the business which is not subject to tax. In our opinion, the answer to this question is clearly in the negative, and that only that portion of the expenditure which is attributable to the "taxable" part of the business may be deducted.

The section of the Income-tax Act under which the profits of a business are taxed is Sec. 10, and the part of this section which is relevant for the present purpose reads as follows:—

10. "(1) The tax shall be payable by an assessee under the head 'Business' in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely:—

(ix) any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains".

The Madras case of *S. A. S. S. Chellappa Chettiar* was principally concerned with the application of the provisions of clause (iii) of sub-sec. (2) of Sec. 10 to a business of the kind which we are now considering, and the question of the extent to which clause (ix) was applicable was merely incidentally considered in the last paragraph of the judgment, where the following sentence occurs:—

"The answer to the second question will admittedly follow from the decision on the first and the answer to it therefore is also in the affirmative".

This is the only reference to clause (ix) in the judgment, and no reasons for this decision are given, and plainly the decision went by default. We therefore refrain from further comment on the Madras case beyond saying that we by no means agree with the admission made before the Madras Court, that the decision regarding clause (ix) necessarily follows the decision regarding clause (iii).

Before us, on behalf of the assessee great stress has been laid on an English decision of the Court of Appeal, *Hughes v. Bank of New Zealand* (1936, 3 All. E.R. 975), which was referred to in *S. A. S. S. Chellappa Chettiar's case* as having been received in Madras after the arguments in that case had been heard. But extreme care must be taken in applying English decisions to cases under the Burma Income-tax Act, because the scheme of the English Income-tax Act, 1918, and the scheme of the Burma Income Tax Act, 1922, are entirely different. In England a person is assessed to income-tax in respect of his income, while under the Burma Act it is the income which is taxed. Under the

English Act no class of income is outside the scope of the Act, whereas by Sec. 4 (3) of the Burma Act the Act is made inapplicable to a number of classes of income. The English Act merely confers certain exemptions on a person in respect of his income up to a certain amount or of certain kinds, similar to the exemptions conferred on certain classes of income by the provisos to Secs. 8 and 9 of the Burma Act. Moreover, the "expenses deduction" clause (if it may be so called) of the English Act is in different and far wider terms than that of the Burma Act. The rule in the English Act in respect of such deductions reads:—

"In computing the amount of profits or gains to be charged, no sum shall be deducted in respect of—

(a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation."

The distinction between the expression "incurred solely for the purpose of earning such profits or gains" and the expression "expended for the purpose of the trade, profession, employment or vocation" is so manifest as to need no comment. The question before us for decision therefore has to be decided with reference to the provisions of the Burma Income-tax Act and a reference to decisions under the English Act will afford no assistance.

Now, "agricultural income" is defined in Sec. 2, sub-section (1), of the Act, and so far as it is relevant for the present purpose means—

(a) "any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land revenue in Burma or subject to a local rate assessed and collected by officers of Government as such;

(b) any income derived from such land by agriculture".

Section 4, sub-sec. (3), clause (viii) of the Act, enacts that the Act shall not apply to agricultural income. In *Commissioner of Income-tax, Bihar & Orissa v. Maharajadhiraj of Darbhanga* (I.L.R. 14 Pat. 623) their Lordships of the Privy Council held that by this clause agricultural income is altogether excluded from the Act, howsoever and by whomsoever it may be received.

Sec. 6 of the Act enacts—

"6. Save as otherwise provided by this Act, the following heads of income, profits and gains shall be chargeable to income-tax in the manner hereinafter appearing, namely:—

... ..

(iv) Business".

Sec. 4, sub-sec. (1) enacts—

"4. (1) Save as hereinafter provided, this Act shall apply to all income, profits or gains as described or comprised in Sec. 6".

Their Lordships of the Privy Council held in the *Maharaja of Darbhanga's Case* (I.L.R. 14 Pat. 623 at page 632) that the effect

of the saving words at the beginning of each of these two sections is to exclude "agricultural income" altogether from the scope of the Act. Hence "business" as defined in Section 6 (iv), does not include the business of leasing agricultural land and receiving the rents, and the expression "profits or gains of any business", as used in Section 10 (1), does not include "agricultural income". It therefore follows that the expression "such profits or gains" in clause (ix) of Section 10 (2) does not include "agricultural income" and consequently, when the business of an assessee comprises both agricultural income as defined in the Act, and other (taxable) income, the assessee is not entitled under Section 10 (2) (ix) to deduct from such other income the expenditure incurred for the purpose of earning the agricultural income.

Mr. Clark, for the assessees, has sought to draw a distinction between Section 12 and Section 10 of the Act, and has urged that because the words "from every source to which this Act applies" are used in Section 12, but are omitted in Section 10, therefore Section 10 must be held to refer to profits or gains of every kind. The distinction is merely imaginary. It was necessary to insert these words in Section 12, for otherwise the words "every source" would include sources which are outside the scope of the Act, and if Mr. Clark's argument were to be accepted, then agricultural income would be taxable under Section 10 if it formed part of a business, a result which would be contrary to the decision in the *Maharaja of Darbhanga's Case*.

In my opinion the case of agricultural income of a business is comparable to that of the profits of a foreign branch of a business (which profits are not brought into Burma); both are entirely outside the scope of the Act. *M.T.T.K.M.S.M.A.R. Somasundaram Chettiar v. Commissioner of Income Tax, Madras* and the *Provident Investment Co., Ltd. v. The Commissioner of Income Tax, Bombay*. It would never, I imagine, be contended that, where a business in Burma had a branch abroad, the profits of which were not assessable, the expenses of running the foreign branch could be deducted under Section 10 (2) (ix).

The question referred must therefore be answered in the negative. The Commissioner of Income-tax is entitled to his costs of this reference, advocate's fee 20 gold mohurs.

MYA BU, J.—I agree.

ROBERTS, C. J.—I agree.

Reference answered in the negative.

[IN THE PRIVY COUNCIL.]

P. C. MULLICK AND ANOTHER (EXECUTORS)

v.

COMMISSIONER OF INCOME TAX, BENGAL.

LORD RUSSELL OF KILLOWEN, LORD ROMER, SIR SHADI LIAL,
and SIR GEORGE RANKIN.

February 1, 1938.

INCOME—ALLOCATION OF REVENUE BEFORE IT BECOMES INCOME AND APPLICATION OF INCOME FOR SPECIFIC PURPOSES DISTINGUISHED—EXECUTORS—PAYMENTS MADE FOR *Sradh* OF TESTATOR AND FOR COSTS OF PROBATE—WHETHER DEDUCTIBLE FROM ASSESSABLE INCOME.

A testator had by his will appointed the appellants his executors and had directed them to pay Rs. 10,000 out of the income of his property on the occasion of his addya sradh for expenses in connection therewith to the person who was entitled to perform the sradh. He had also directed them to pay out of the income of his property the costs of taking out probate of his will. During the year of account the executors had paid Rs. 5,537 for expenses in connection with the addya sradh and a sum of Rs. 1,25,000 for probate duty: Held, affirming the judgment of the Calcutta High Court, that the payments made for the sradh expenses and the costs of probate could not be excluded in computing the chargeable income. These were payments made out of the income of the estate coming to the hands of the appellants as executors and in pursuance of an obligation imposed by the testator. It was not a case in which a portion of the income was by an overriding title diverted from the person who would otherwise have received it as in Bejoy Singh Dudhuria's Case, but a case in which the executors having received the whole income apply a portion of it in a particular way.

P. C. MULLICK AND D. C. AICH, IN RE [1936 I. T. R. 369] affirmed.

RAJA BEJOY SINGH DUDHURIA'S CASE [1933 I.T.R. 135; 60 I.A. 196; I.L.R. 60 Cal. 1029] distinguished.

Appeal from a decision of the High Court of Judicature at Fort William in Bengal reported as *P. C. Mullick and D. C. Aich, In re* [1936 I.T.R. 369]. P. C. Appeal No. 32 of 1937.

*L. P. E. Pugh, K. C., and W. Wallach, for the appellants.
Hubert Hull, for the Respondents.*

JUDGMENT.

LORD RUSSELL OF KILLOWEN.—The executors of a testator (one Akshoy Kumar Ghose, deceased) appeal from a judgment of the High Court of Judicature at Fort William in Bengal delivered on a reference by the Commissioner of Income-tax under Section 66, Sub-sections 1 and 2 of the Indian Income-tax Act.

The testator died in October, 1931. By his will he appointed the appellants (and another) his executors. He directed them to pay his debts out of the income of his property, and to pay Rs. 10,000 out of the income of his property on the occasion of his "Addya Shradh" for expenses in connection therewith to the person entitled to perform the Shradh. He also directed his executors to pay out of the income of his property the costs of taking out probate of his will. After conferring out of income benefits on the second wife and his daughter and (out of the estate) benefits on the sons, if any, of his daughter, and after providing for the payment out of income "gradually" of divers sums to some persons, and certain annuities to others, he bequeathed all his remaining property (in the events which happened) to a son taken in adoption after his death by his wife, viz., one Ajit Kumar Ghosh who is still a minor. The title of the son is defeasible in the event of his dying childless during the lifetime of the testator's wife, and until he attains the age of 25 years the property has to remain in the possession of the executors who are to defray the expenses of education, maintenance and other necessary expenses out of the income of the estate.

By an assessment order dated October 26, 1933, the executors were assessed to income-tax for the year 1933-4 in respect of their income of the previous year. During that year (*viz.*, 1932-3) the executors had expended a sum of Rs. 5,537 for expenses in connection with the "Addya Shradh" and a sum of Rs. 1,25,000 for probate duty. They had also during the same period made certain payments to the persons entitled under the will to "gradual" payments, and annuities. The Income-tax Officer assessed the income of the appellants of the year 1932-3 liable to tax for the year 1933-4, at Rs. 81,078.

He arrived at this figure by the following procedure:—He ascertained the total taxable income received during the relevant year as amounting to Rs. 1,89,901, and the agricultural income (within the meaning of Section 4 (3) (viii) of the Act) so received at Rs. 90,015. He next ascertained the obligations which fell to be discharged by the executors during the year out of the income

of the testator's estate. These obligations (which he termed "charges") were of different kinds. Some arose under the will of the testator's father; others consisted of the annuities payable under the testator's will and of the payments actually made during the year in respect of the sums thereby directed to be paid "gradually".

These "charges" he treated (being, as he thought, bound to do so by the decision in *Raja Bejoy Singh Dudhuria v. Commissioner of Income Tax, Calcutta*) as of such a nature that the moneys required to meet them could not be regarded as income of the appellants. But since the "charges" were payable out of the whole income whether taxable or not, he apportioned the "charges" between the taxable income and the agricultural income, allocating the sum of Rs. 35,520 to the taxable income with the result that of the said sum of Rs. 1,89,901 he treated only the sum of Rs. 1,54,381 as income of the appellants. This amount he further reduced by making deductions in respect of the Rs. 5,537 expended during the year in respect of the testator's "*Addya Shradh*". Certain other adjustments had to be made (chiefly concerned with outgoings in respect of the house property) which further reduced the sum of Rs. 1,54,381 to a sum of Rs. 1,22,396. This he fixed as the "total income" of the executors. He then deducted from that total income so much thereof as was represented by interest on securities and dividends taxed at the source and assessed the executors as liable to pay tax on the balance. He refused to treat the expenses of probate as one of the "charges," the amount of which could not be regarded as income of the executors, and accordingly made no allowance or reduction in respect thereof.

On appeal to the Assistant Commissioner the total income liable to tax was reduced to a sum of Rs. 59,344. The reasons for this reduction are immaterial, because upon all the points involved in the present appeal the Assistant Commissioner agreed with the course adopted by the Income tax Officer.

The executors then applied to the respondent to refer five questions of law to the High Court under Section 66 (2) of the Act. The respondent, for reasons which need not be specified, only referred three of the questions, but added an additional one on his own motion under Section 66 (1).

The questions so referred were as follows :—

Question 1.—Whether or not in computing the chargeable 'income' the whole of the amount (Rs. 10,000) provided in the will of Akshoy Kumar Ghosh as payable 'out of income' on

account of his 'sradh' should have been left out of calculation, and not merely the actual amount paid in the year of assessment on account of the same (Rs. 5,537)?

Supplementary Question.—Whether in computing the income chargeable to tax in this case, the Income Tax Officer should, on a proper application of the law, have excluded no part of the sum of Rs. 10,000?

Question 2.—Whether or not the cost of obtaining probate of the Will of Akshoy Kumar Ghosh should have been excluded from the chargeable 'income' of the assessee, particularly in view of the express provisions in the will and the same shall be payable out of the income?

Question 3.—Whether or not the assessee was entitled to credit for the full amount of deductions of tax at source on account of securities and dividends, without any abatement in respect of the proportionate amount or charges allocated to and allowed against the total receipt from such sources?

The respondent as provided by Section 66, expressed his own opinion which was in all respects adverse to the contentions of the executors. Both members of the High Court held as regards question 1 and the supplementary question that no part of the income of the executors applied for expenses in connection with the Addya Shradh should be left out of the account in computing the taxable income of the executors and that no allowance or deduction should be made in respect thereof. As regards question 2 both members of the High Court were of the like opinion as regards the costs of probate. As regards question 3 the Chief Justice thought that the question was one of fact and should not have been referred. COSTELLO, J., held that upon the facts when ascertained the executors had no ground for complaint. The third question was accordingly not answered by the High Court.

The executors have appealed to His Majesty in Council, and in the course of the argument a point arose which must be dealt with *in limine*. It was suggested that the assessment should be treated as being not an assessment upon the executors in regard to the income of the executors, but an assessment upon the appellants as trustees (under Section 40 of the Act) for the residuary beneficiary Ajit Kumar Ghosh. In their Lordships' opinion this contention is not open to the appellants. The matter has all along proceeded and been argued by both sides upon the footing that the assessment was an assessment of executors' income. There is no evidence that at the relevant date the estate had been cleared and was held by the appellants simply as trustees, indeed the indications are all the other way. It is true that the assessment order refers to the infant son as the sole beneficiary. It is also true that in some respects the procedure adopted by the Income Tax Officer is logically more applicable to the ascertainment of residuary income than to the calculation of the total income of an estate, a

fact which in all probability is the result of a desire on the part of the authorities to act with fairness to all concerned. But however that may be, the assessment in its present form stands, subject only to the question which their Lordships have to decide, viz., whether the High Court has correctly answered the questions submitted to it.

Their Lordships agree with the answers given to question 1, the supplementary question and question 2. The payment of the Shradh expenses and the costs of probate were payments made out of the income of the estate coming to the hands of the appellants as executors, and in pursuance of an obligation imposed by their testator. It is not a case like the case of *Raja Bejoy Singh Dhudhuria v. Commissioner of Income Tax, Calcutta*, (*supra*) in which a portion of income was by an overriding title diverted from the person who would otherwise have received it. It is simply a case in which the executors having received the whole income of the estate apply a portion in a particular way pursuant to the directions of their testator, in whose shoes they stand.

As regards question 3 their Lordships think that it might well have been answered in the negative. It appears to have been based upon a misunderstanding by the appellants of the situation. Had they been in fact charged with any tax deducted at source they would have been entitled to credit for that amount; but in fact the whole of the sums in respect of interest on securities and dividends which were brought in as gross for the purpose of ascertaining the total income of the executors, was deducted for the purpose of fixing the income on which tax was to be charged. They have not been charged with any tax deducted at source.

Their Lordships are of opinion that this appeal fails and should be dismissed. They will humbly advise His Majesty accordingly. The appellants must pay the costs of the appeal.

Appeal dismissed.

Solicitors for the appellants : *W. W. Box & Co.*

Solicitor for the respondent : *Solicitor, India Office.*

[IN THE RANGOON HIGH COURT].

B. B. JUBB.

v.

COMMISSIONER OF INCOME TAX, BURMA.

SIR GOODMAN ROBERTS, C. J., MYA BU, J., and SHARPE, J.

January 14, 1938.

BUSINESS INCOME—PROFIT ARISING FROM SINGLE TRANSACTION OF SALE—WHETHER INCOME FROM BUSINESS OR ACCRETION

TO CAPITAL—TESTS—FINDING OF INCOME TAX AUTHORITIES—FINALITY—CASUAL AND NON-RECURRING RECEIPT—INDIAN INCOME TAX ACT (XI of 1922), Sec. 4 (3) (vii).

The assessee acquired rights in respect of a mine in 1932. He sold these rights in 1934 at a profit of Rs. 91,000 and purchased a rubber estate with the sale proceeds of the mining rights. The income tax authorities found on the facts that the assessee had acquired the mine with the object of re-selling it at a profit and that the re-sale was not effected entirely to find assets for the purchase of the rubber estate, and assessed income tax on the profit made by the re-sale. The assessee contended that there was only an accretion to his capital. Held, on a reference made by the Commissioner, (i) that there was evidence in the case upon which the income tax authorities could find that the assessee's surplus arising from the sale of the mine was a profit of his business, and (ii) they had not misdirected themselves in principle or law in coming to such a conclusion.

The real question in such cases is whether there was a gain made in an operation of business in carrying out a scheme for profit-making. It is not correct to say that unless there was a primary intention at the time of acquisition to enter on an adventure in the course of trade it cannot be found that such an adventure was subsequently entered into unless there were a series of transactions.

REES ROTURBO DEVELOPMENT SYNDICATE v. INLAND REVENUE COMMISSIONERS (13 Tax Cas. 366; 97 L.J.K.B. 817; 1928 A.C. 132) applied.

Reference made by the Commissioner of Income Tax, Burma, under Sec. 66 (2) of the Burma Income tax Act, 1922. (Civil Ref. No. 5 of 1937).

The material portions of the Commissioner's Statement of Case are extracted below :—

"By the Assessment Order, copied as annexure A, assessment was made in respect of a Total Income of Rs. 1,06,952."

By the Appellate Order in question, which with the grounds of appeal is copied as Annexure B, the assessment was reduced to Rs. 98,126 : comprising *inter alia* Rs. 91,000 determined to be amount of chargeable income which the assessee received in the previous year by sale of the " (Yemone) Island Tin Mine."

The assessee has required reference of the questions in respect of the said Rs. 91,000 which are copied as Annexure C. Briefly the contention is that the surplus derived from the sale is not chargeable under the Act. It is contended incidentally that the Assistant Commissioner's ultimate essential finding (as to "Capital" or "Revenue" nature of the transaction) is in part

based on erroneously found primary "facts". The petition alleges further that in any event the amount of the determination is in excess of the actual accountable surplus.

The questions of law which in the Commissioner's finding properly arise from the Appellate Order upon the contentions presented, are set out in paragraph 19 below, and these questions are referred.

2. **Statement of facts.**—Mr. Jubb acquired rights in respect of the Yemone Mine (or rather, Mining area) from June 1932. He sold these rights in May 1934 for £ 11,000 (Rs. 1,46,412). The sale negotiations were pressed on with, to enable him to have funds within time for a Government sale of the Mergui Crown Rubber Estate. His case is that he acquired the area as a productive capital asset, and sold it only by way of realizing that asset for exchange into the Rubber Estate.

The Assistant Commissioner found—

(a) Jubb, who had previously admittedly sold one such area by way of "business", similarly acquired this one without working capital enough to work it fully and "in a proper manner" but with the object of selling it at a profit by way of "business".

(b) The relationship of this sale to the purchase of the Rubber Estate was incidental, and not essential.

* * * *

7. **Finding as to original acquisition.**—It is found accordingly (a) that the area is one requiring considerably more capital than Jubb had any hope of handling, for its full effective development; although it was such that small-scale extraction could be profitably carried on, parallel with the further "proving" of the area, while prices of tin were at the 1932-33 level or higher.

(b) Jubb was well acquainted with it, and in April 1932, had a definite anticipation of having capital enough to do some small scale working upon it. He began this on "tribute" terms, but with anticipation of being able to take over permanent rights, but that if it turned out well and the price of tin rose he could expect to dispose of those rights at a profit.

(c) He found the current working profitable, and was able to acquire the rights; and accordingly did so, subject to payment which he was not actually able to complete until he had secured a purchaser.

(d) He had been, and now was, engaged in taking up and "proving" mine-areas with a view to sale at profit as his "business". The process was not inconsistent with, and indeed in part entailed, his producing and selling ore meantime from such areas.

* * * *

10. **Finding as to Sale of the Mine.**—It is not impossible that Jubb was to some extent trying to stimulate a dubious purchaser

by over-emphasising his own motive for sale. But there is no doubt that at the time of the sale he was also in truth anxious to realise the money for enabling his own purchase of the Rubber Estate.

On the other hand, apart from any doubt attaching to the January letter, the terms even of the option agreement as mentioned in the telegram above imply that even when that agreement was made Jubb had not considered the sale as contingent wholly upon his intention to tender for the Rubber Estate. I conclude, in agreement with the Assistant Commissioner, that although the course of the sale negotiations was certainly influenced by this available opening for using the sale-price, the sale was not undertaken solely because of there being this opening. Also that such a sale was in any event the original object of the acquisition, which intention would not be in any way taken out of the case, if indeed the sale were in the event made at a time and price influenced by the existence of that opening.

12. **Opinion of the Commissioner.**—I find no reasonable contention as to there not being plain material for the “primary” facts found as summarised in paragraphs 7 and 10 above. The sole contendable issue of law is as to the “Capital” or “Revenue” character of the transaction, to be inferred from those facts.

13. On that issue, there is an embarrassment of case law, both as regards the scope of the authority on law (in relation to that of the appellate authority on “fact”); and upon the essential issue itself.

14. As regards the respective responsibilities in law and fact, it has even been observed judicially that the authorities cannot be reconciled (13 T.C. 393); and (12 T.C. 262) that there is a tendency in a judge whose opinion differs from that of the authority on fact to determine the issue to be one of law in order that he may review it. I will only mention 18 T.C. 555 and 7 I.T.C. 411 as inviting me to treat the issue here as fact. But in view of the line adopted in what is I think now the leading case on the actual problem itself, viz., 19 T.C. 390 (and of the dicta at 14 T.C. 403) I think the issue ought to be referred, on the following basis.

The distinction between “Capital Accretion” and “Income, Profits or gains” is, in border-line cases, a practical commercial and accounting problem properly within scope of the authority required by the legislature to settle such matters: not *primarily* an issue for lawyers. But because it involves inferences and deductions from simple “fact”, it remains possible for lawyers to extract, if not a satisfactory definition, at least some guiding principles and to say in certain cases that the responsible authority has gone counter to such a principle. The question to be put as of law is whether the primary facts could not lead to the inference drawn without contravention of some such principle.

15. As to the issue so referable: two cases of other Mergui prospectors have been decided in this Court, and with different results.

5 I.T.C. 451 was concluded on the lines that "that there was ample evidence to justify the finding at which the income tax authorities arrived, namely, that the assessee intended.....*as a matter of business* to prospect for tin with a view not to working the mines himself, but if he was fortunate enough to find tin to sell his right".

The other case concerned one of the Milne brothers referred to in the course of this present statement as having bought the Kywekayan area from this assessee after having lent him money: viz., 7 I.T.C. 67. In that case also another embarrassed minor (actually the same man as in the 5 I.T.C. case) borrowed money from them, and they covered the loan by securing from the borrower a share in the sale proceeds which should be realised from his mine. As I follow the ratio decidendi in that case, the decision against the Revenue turned wholly on the ground that the lender's profit was derived from the isolated transaction of loan, and not from anything of the nature of prospecting, etc.

16. I do not think any other of the many cases of this "Capital" issue can usefully be cited, except the original (United Kingdom) Mining Case 5 T.C. 159. There is now in 19 T.C. 319 an authoritative summary of the whole range of the cases, but I do not think anything more directly relevant can be extracted from it.

17. It may be advisable however, to refer to certain difficulties commonly raised in such cases in India: even though only to suggest that they do not lie across the present case.

Assessee generally refer to the dictum in 6 I.T.C. 178 at foot of page 180: extracting the reference to "regularity or expected regularity", and the analogy with "fruit of a tree". The implication of the dictum has been discussed in 8 I.T.C. 64. It seems to me plain not merely that Sir George Lowndes cannot have meant to sweep aside the long list of "single transaction cases"; but also that he did not do so. This seems clear from the continuing sentence beginning, "The source....."; as well as the addition to the analogy, namely, "the crop of a field" which may be, and often is, a "single transaction". (Of course the present is not a "single" transaction, but it is apparently one of only two, and is described by the petitioner as "non-recurring").

18. The question is simply whether Jubb acquired his rights with a view to profiting mainly by the annual yield of the mining, or mainly with the intention of "busying himself" about making them saleable for more than what he had to pay to acquire them. When that fact is settled the charge seems to me to be outside any arguable margin at all.

A man may buy a capital asset, intending to realise it after a greater or less interval, and in all prudence would then have an eye to its probable saleable value. A surplus on such a realization would obviously not be chargeable. On the other hand, if it is his business to acquire and sell, the circumstance that there may be *some* mesne profits will not alter the character of the (further) profit on selling what was meantime producing them.

Intention is not a concrete fact, but undoubtedly it is "fact" (as in criminal cases dependent upon intention); and it has been found that Jubb's intention throughout was to sell the mine at a profit. It is found that this was part of his business. It is found that he busied himself about equipping, working and prospecting in the area with a view to selling at a profit. The fact that to some extent he chose his time for selling with reference to a projected purchase, which *may* have been an investment (and not another deal for resale), has been considered, and held not to discount the inference from the other relevant facts.

19. Accordingly I find the only questions of law arising to be—was it impossible for the Assistant Commissioner to infer from the primary facts in record before him that the assessee's surplus arising from sale of the "Yemone) Island Mine" was a profit of his business?

Did the Assistant Commissioner misdirect himself in principle and law in reaching the said inference?

In the Commissioner's opinion it was possible for the Assistant Commissioner to draw the inference he drew, and he did not misdirect himself in reaching it."

Advocate General, for the Commissioner.

Foucar, for the Assessee.

JUDGMENT.

ROBERTS, C. J.—The following questions have been referred to this Court for determination in Civil Reference No. 5 of 1937 :

"1. Was it impossible for the Assistant Commissioner to infer from the primary facts in record before him that the assessee's surplus arising from sale of the "Yemone) Island Mine" was a profit of his business?

2. Did the Assistant Commissioner misdirect himself in principle and law in reaching the said inference?"

The only point of law which could arise in the determination of these two questions is the proper legal effect of the facts as proved.

The assessee, Mr. B. B. Jubb, bought a rubber estate in 1924 which he sold two years later. In 1928 he obtained a licence of

the Kywekayan area by way of prospecting, but having later abandoned it, he brought his plant to Mergui. In 1932, during the earlier part of the year, he was employed in the Shan States, but he went to Mergui in the month of April and stopped on his way at Rangoon in order to see the Official Assignee. The Mergui Tin Dredging Company, which had originally owned the Yemone Tin Mine, had just gone into liquidation, and Mr. Jubb arranged to work the mine with his own money under an agreement with the Official Assignee by which 10 per cent of the gross price realised from the sale of the tin obtained from the mine should be paid to the Official Assignee. Under this agreement he worked it from June to November 1932, and in March 1933 Mr. Jubb entered into a contract with the Government whereby the lease should be taken over in his name on his liquidating all outstanding arrears of rent and other debts owing to the Government. At this date, in May 1933, it appears he was making an offer to pay, by instalments as it is said, for a rubber estate which he ultimately purchased and the purchase money for which was obtained by the sale of the Yemone Tin Mine in June 1934. In all these circumstances the Assistant Commissioner of Income Tax found that it was clear that the sale of the mining areas acquired from the Mergui Tin Dredging Company Limited was not a capital transaction, nor as such outside the scope of the Income Tax Act, but that it was the appellant's business to secure mining areas with a view to their resale. His rights in the Kywekayan area had been sold for Rs. 15,000 to a man named Milne, and the Assistant Commissioner has found as a fact that he entered early into negotiations for resale of the tin mine which showed definitely that he proposed to dispose of it as soon as he could obtain a suitable buyer. It was said that the reason he was anxious to sell was to obtain money for the purpose of a rubber estate. But all these questions appear to me to be questions of fact which it was for the income-tax authorities to decide, and although we do not necessarily say that we should come to the same decision upon the facts as they have done, it is in our opinion clear that there was evidence upon which they could arrive at the conclusion they did.

Mr. Foucar has been driven to contend that unless there was a primary intention at the time of his acquiring the Yemone Tin Mine to enter on an adventure in the course of trade it cannot be found that such an adventure was subsequently entered into unless there were a series of transactions. We think this view of the law is based upon a misconception, and that in the words of LORD BUCKMASTER in *The Rees Roturbo Development Syndicate Ltd. v. Commissioners of Inland Revenue* (13 T.C. 366) the real question is whether there was a gain made in an operation of business in carrying out a scheme for profit-making. In applying this test we are satisfied that the Assistant Commissioner in no way misdirected himself in principle or law, and that there was evidence upon which he could conclude that the assessee's

surplus arising from the sale of the mine was a profit of his business.

I would accordingly answer both questions in the negative.

We assess the Advocate's fee for this reference at ten gold mohurs.

MYA BU, J.—I agree.

SHARPE, J.—This Court is not competent to investigate matters of fact in a reference such as the present one. Whether or not in any particular case there is any evidence to support the finding of fact arrived at below is, of course, a question of law; but such question of law is entirely limited to whether there was any evidence, and, if there was any evidence, then the finding of fact must stand, although the appellate tribunal might itself have found the facts in a contrary way. Here, in my judgment, there was clearly evidence to support the finding arrived at, and it is immaterial to consider what decision we in this Court would have arrived at if we had been the judges of fact, which we are not. The first question submitted must accordingly be answered in the negative.

As to the other point referred—a case such as the present is governed by the principles laid down in the House of Lords in the case of *The Rees Roturbo Development Syndicate Ltd., v. Commissioners of Inland Revenue* (13 Tax Cases, 395) to which my Lord, The Chief Justice, has referred. I cannot see that the Assistant Commissioner, in arriving at the decision which he did, acted in any way contrary to principles there enunciated. It is immaterial to consider whether we in this Court, applying those same principles to the question of fact to be decided, would have arrived at the same conclusion. Therefore, the second question submitted must also be answered in the negative.

I agree with the proposed order as to costs.

Reference answered accordingly.

[IN THE ALLAHABAD HIGH COURT.]

SIR ADITYA NARAIN SINGH BAHADUR,
(*Maharaja of Benares*).

v.

COMMISSIONER OF INCOME TAX, CENTRAL
AND UNITED PROVINCES.

COLLISTER and BAJPAL, JJ.

January 24, 1938.

NON-RESIDENT—ASSESSMENT OF NON-RESIDENT WITHOUT
APPOINTING AGENT—LEGALITY—INDIAN AND ENGLISH LAW COM-
PARED—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 42 (1).

Under Section 42 (1) of the Indian Income Tax Act in the case of a non-resident it is the agent alone and not his non-resident principal that can be treated as the assessee, i.e., the person to whom a notice under Section 22 (2) shall issue and by whom the tax is payable. The word 'shall' used in Section 42 (1) shows that the provisions of the section are mandatory and the department is precluded from issuing notices to the principal and from treating the principal as the assessee except to the limited extent that any arrears of tax may also be recovered from assets of his which may be found in British India. The Indian law differs from that of England in this respect.

Chief Commissioner of Income Tax, Madras v. Bhanjee Ramjee & Co. (44 Mad. 773) dissented from.

Cases referred to :

CHIEF COMMISSIONER OF INCOME TAX, MADRAS *v.* BHANJEE RAMJEE & Co., [1922] (I.L.R. 44 Mad. 773 ; 1 I.T.C. 147).

COMMISSIONER OF INCOME TAX, BOMBAY *v.* NATIONAL MUTUAL LIFE ASSOCIATION OF AUSTRALASIA [1933] (I.L.R. 57 Bom. 519 ; 1933 I.T.R. 350 ; 35 Bom. L.R. 896).

TISCHLER *v.* APTHORPE [1885] (52 L.T. 814 ; 2 Tax Cas. 89).

WERLE & Co. *v.* COLQUHOUN [1888] (20 Q.B.D. 753 ; 57 L.J.Q.B. 323 ; 58 L.T. 757 ; 2 Tax Cas. 402).

Case stated by the Commissioner of Income Tax, Central and United Provinces under Section 66 (2) of the Indian Income Tax Act, 1922. [Miscellaneous Case No. 52 of 1936].

The facts of the case, the questions referred and the opinion of the Commissioner appear in the following Statement of Case made by the Commissioner :—

STATEMENT OF CASE

" Case stated by the Commissioner of Income-tax, Central and United Provinces, at the instance of Captain, His Highness Maharaja Sir Aditya Narain Singh Bahadur, K.C.S.I., Ramnagar, Benares State, an individual within the purview of Section 3 of the Indian Income-tax Act, XI of 1922 (hereinafter referred to in this statement as the assessee) under Section 66 (2) of the Act, for the decision, by the Hon'ble the High Court of Judicature at Allahabad, of questions of law, set forth in paragraph 3 of this statement, arising out of the appellate order under Section 31 of the Act, passed by the Assistant Commissioner of Income-tax, Benares, in respect of the assessee's assessment for the year 1934-35 (hereinafter referred to as the year in dispute).

2. **Facts of the Case.**—The assessee has a dual capacity (1) as the ruling chief of the quondam family domains converted into an Indian State called the Benares State outside British India, and

(2) a landholder in British India. He owns extensive property in his latter capacity and is in receipt of (1) *Nazarana* and (2) *Zare Chaharam* from his zamindari villages in British India. The assessee normally resides at Ramnagar, the capital of the State, but has a residence also in a place known as the Nandesar House in the City of Benares. This place is occupied by him now and then as a residence. It is not disputed that for the most part he lives in the Benares State outside British India. For the year in dispute as in all the years anterior to it, the Income Tax Officer issued by registered post a notice under Section 22 (2) addressed by the name of the assessee to his place Nandesar House in Benares, requiring him to file a return of his (British Indian) income in the previous financial year (year ending March, 1934). In response to this notice return was filed showing an income of Rs. 48,948. In response to notices under Sections 22 (4) and 23 (2) similarly addressed, the assessee's representative produced the zamindari accounts. These showed that the annual letting value had been excessively returned while (1) Rs. 3,288 being "*Nazarana Tamirat Makanat*" (fees charged for according sanction to build houses in zamindari villages) and Rs. 1,992 *Zare Chaharam* (one-fourth of the sale price of a house sold) together with certain other dues aggregating in all to Rs. 10,292 had not been included in the return. After allowing the statutory deductions and management charges the Income Tax Officer made an assessment in the amount of Rs. 48,880 to income tax amounting with surcharge to Rs. 7,955-11 and super tax inclusive of surcharge to Rs. 1,106-4. His assessment order is copied and annexed as Appendix A. The assessee appealed contending *inter alia*, that the assessment was illegal and improper because (1) he was not a resident of British India and no agent within the purview of Sections 42 and 43 of the Act had been appointed by the Income tax Officer, (2) the Income tax Officer had no jurisdiction over Ramnagar, the place where he was permanently resident, (3) the notice under Section 22 (2) was illegal and invalid, (4) the assessment could not have been in his name and should have been in any case in the name of his agent when he was non-resident, (5) he was a ruling chief and not a British Indian subject and was not responsible under the Act, (6) the *Nazarana* and *Zare Chaharam* receipts were agricultural income and not liable to be taxed. Overruling these contentions the Assistant Commissioner, for reasons given in his order (Appendix B), reduced the total income to Rs. 47,174, holding, with reference to the question of validity and jurisdiction, that the assessment was in order and, with reference to the *Nazarana* and *Zare Chaharam*, that it was not agricultural income, not being, in terms, within the exemption conferred by clause (viii) of Section 4 (3) of the Act. The assessee has now filed an application under Section 66 (2) demanding a reference on six questions framed by him embodying the three contentions described above.

Questions for the decision of the Hon'ble High Court—The six questions proposed in the application actually resolve themselves into the following questions which I accordingly refer :

(1) In the circumstances stated, was the income from (a) *Nazarana*, and (b) *Zare Chaharam* agricultural income within the meaning of this expression in Section 2 (1) of the Act ?

(2) Granting that the assessee was a non-resident, was the Income Tax Officer precluded by any provision of the Act from serving a notice on him without appointing an agent within the meaning of Section 43 ?

(3) Was the assessee exempt from taxation in respect of this property because he was a Ruling Prince ?

4. Opinion of the Commissioner.—The facts are not disputed in this case. The question is entirely one of their interpretation. Question (1): As already stated (a) the *Nazarana* is the fee taken by the assessee for according sanction to build houses, and (b) *Zare Chaharam* is a fourth of the sale-proceeds taken by him for the sale of houses on sites belonging to him. The receipts have no connection with agricultural income as defined in the section quoted in the question even if it were assumed that some of the owners of the houses were cultivators of the assessee's land. If your Lordships hold that this income is agricultural, then there is no dispute as regards its exclusion. My submission is that it is not agricultural income and that the question should be answered in the negative.

The second question is whether, when an assessee is a non-resident it is imperative that the assessment must be made in the hands of his agent within the meaning of Sections 42 and 43 of the Act or whether it is optional with the Income-tax Officer to assess him directly, that is to say, without the instrumentality of an agent as he has done in this case. Be it remembered that the question of residence was not raised before him and all the notices he had issued down to the notice of demand, had been accepted on behalf of the assessee and, what is more important, complied with without demur. They were all addressed to the assessee by his British Indian address and their compliance is the admitted evidence of their reaching him. Section 43 gives an Income-tax Officer discretion to treat certain persons as agent of a non-resident for the enforcement of the liability in special cases under Section 42. This section does not create any liability that is not already there in Section 4 (1) of the Act and is an extension of the meaning of this section : not a section that creates a new liability but one that facilitates assessment and collection of the demand in the case of non-residents, or in other words a machinery section—not a section that lays down that the profits or gains are assessable to income-tax only in the name of an agent of the non-resident: *Chief Commissioner of Income Tax, Madras*

v. Bhanjee Ramjee & Co. It was, therefore, open to the Income Tax Officer to address notices direct to the assessee even though he be a non-resident. That is what he has done and the fact that the notices were served on the representative of the assessee in British India without recourse to the provisions of Section 43, therefore, makes no difference to the validity of the assessment specially as the notices duly reached the assessee and were formally complied with. My submission, therefore, respectfully is that this question should also be answered in the negative.

As regards question (3), it is sufficient for me to refer to *Ram Prasad, In re* (I.L.R. 52 All. 419) where the learned Judges who decided that case observed as follows (at page 423) :

“In may be that the person who governs the State is a single individual or a body of persons. In either case, the governing authority, single or several in numbers, will come within the definition of “person” in Section 65 of the Government of India Act and those persons carrying on business within British India would be subject to any law that the Indian legislature should frame and promulgate.”

What is here affirmed of such person carrying on business within British India is plainly equally applicable to such persons owning property in British India.

5. As required by rule 7 of the Rules framed by the High Court, a relevant portion of the statement of the case was sent to the assessee for observations and suggestions. A copy of his letter is annexed as Appendix D. The words “now-a-days” in the second paragraph of his letter is a mistake for “now and then”. Otherwise the contents of this paragraph are not disputed. As regards the third paragraph of the letter the question framed by me is, in my humble opinion, sufficiently clear and I do not consider it necessary to amend it nor do I consider it necessary to amend the third question when it is not disputed that the property in question is not the property of the State but is of the assessee in his capacity as a landholder in British India.”

P. L. Banerji and B. Malik, for Applicant.

N. P. Asthana, for opposite party.

JUDGMENT.

COLLISTER AND BAJPAI, JJ.—This is a reference by the Commissioner of Income Tax, Central and United Provinces, under Section 66 (2) of the Income Tax Act, which has been made at the instance of the Maharaja of Benares, Captain His Highness Maharaja Sir Aditya Narain Singh Bahadur, K.C.S.I.

The Income Tax Officer assessed the Maharaja to tax on an income of Rs. 48,180 in respect to property in British India. The assessment year is 1934-35. There was an appeal to the Assistant Commissioner, who reduced the estimate of income to Rs. 47,174 but otherwise upheld the assessment of the Income Tax Officer.

Thereafter an application was made to the Commissioner of Income Tax under Section 66 (2) of the Act, requiring him to state a case for the decision of this Court upon certain questions. Three questions of law have been referred to us by the Commissioner. Of these, No. (2) reads as follows :—

“ Granting that the assessee was a non-resident, was the Income Tax Officer precluded by any provision of the Act from serving a notice on him without appointing an agent within the meaning of Section 43 ”?

The Commissioner's opinion is that the question should be answered in the negative. He says :—

“ Section 43 gives an Income Tax Officer discretion to treat certain persons as agent of a non-resident for the enforcement of the liability in special cases under Section 42. This section does not create any liability that is not already there in Section 4 (1) of the Act and is an extension of the meaning of this section ; not a section that creates a new liability, but one that facilitates assessment and collection of the demand in the case of non-residents or in other words, a machinery section—not a section that lays down that the profits or gains are assessable to income tax only in the name of an agent of the non-resident . . . It was, therefore, open to the Income Tax Officer to address notices direct to the assessee even though he be a non-resident. That is what he has done and the fact that the notices were served on the representative of the assessee in British India without recourse to the provisions of Section 43, therefore, makes no difference to the validity of the assessment, specially as the notices duly reached the assessee and were formally complied with ”.

The Commissioner quotes as authority the case of *Chief Commissioner of Income Tax, Madras v. Bhanjee Ramjee & Co.* In that case the assessee was residing in Cochin State but did considerable business in British Cochin. He accepted notices and submitted returns to the Collector of Malabar, of which district British Cochin forms a part for the purposes of income tax. The learned Judges of the Madras High Court were of opinion that the proviso to Section 33 (1) of Act VII of 1918 (which corresponded with Section 42 (1) of the present Act) “ supports the construction that the profits or gains are chargeable if they can be got at in British India whether they are assessed in the name of an agent of the non-resident or not ”. Further on they say :—

“ All that the latter part of the section does is to provide machinery by which the tax can be levied where the non-resident cannot himself be got at ”.

The point fell to be considered by the Bombay High Court in the case of *Commissioner of Income Tax, Bombay and Aden v. The National Mutual Life Association of Australasia Ltd.*, in which

reference was made to *Bhanjee Ramjee & Co.'s Case*. At page 527 (of 57 Bom.) the learned Chief Justice remarked :

"It is, further, to be observed that the Madras High Court in *Chief Commissioner of Income Tax v. Bhanjee Ramjee & Co.*, held that a principal could be assessed under Section 42 without the necessity of appointing an agent under the latter part of the section and Section 43."

At page 535, RANGNEKAR, J., observed :

"In the course of the discussion it was suggested that before Sec. 42 can apply it is necessary that a notice under Sec. 43 must be served on a person by the Income Tax Officer stating that he intended to treat him as the agent of the non-resident person before such person can be treated as an agent and chargeable to income tax within the meaning of section 42, and as that was not done in this case, section 42 did not apply. The answer to the argument is that in this case the principal is sought to be taxed under the Act and the income which was not shown in the return was his income by reason of the meaning of the word "income" in Section 4 as extend by Section 42. The point arose in *Chief Commissioner of Income tax v. Bhanjee Ramjee & Co.*, and it was held that a principal was liable to assessment under Section 42 without an agent being appointed under Section 43. In my opinion this view is correct."

In the case of the *Chief Commissioner of Income Tax, Madras v. Bhanjee Ramjee & Co.*, to which reference has already been made, the learned Judges cited as authority two English cases, namely, *Tischler & Co. v. Apthorpe* (52 L.T. page 814) and *Werle & Co. v. Colquhoun* (20 Q.B.D. page 753). In each of the last-named two cases the assessee was a firm of wine merchants in France doing business in England. In *Werle & Co. v. Colquhoun* (20 Q.B.D. at page 760) LORD ESHER, M. R., observed :

"Another point was raised, that if no one could be found to be assessed under Section 41 of 5 and 6 Vict. C. 35, as an agent or factor, that shewed that no such trade was carried on as was intended by the statute. As to that, I agree with the judgment of MATHEW, J., in *Tischler & Co. v. Apthorpe* that if the Crown can find such an agent as is described in Section 41, they can assess him; but, supposing they cannot, they must take such means as they are able to get at the person who should be assessed. Whether the right means have been taken to assess the appellants we are not asked, and that question is not before us; but I do not think that the right to assess is limited by Section 41, which is only machinery."

The law which governed these decisions was embodied in the statute and section above referred to, namely Section 41 of 5 and 6 Vict. (1842). Now, apart from the danger which ordinarily attends any attempt to apply the analogy of English law to an Indian statute, there are certain important points of distinction between

the law as laid down in Section 41 of 5 and 6 Vict., and the provisions of Section 42 of the Indian Income Tax Act. In the first place, it will be seen that under Section 41 of 5 and 6 Vict. it was enacted that the non-resident should be chargeable in the name of his agent or factor, whereas in the Indian Act the income is made chargeable in the name of the agent; that is to say, in Section 42 of the Indian Act there is no mention of charging the non-resident, but the income is chargeable in the name of the agent, while in the English statute the non-resident himself is chargeable in the name of the agent. In the second place, Section 43 of the Indian Act provides facility for the appointment by the income tax authorities of a person who may be treated as an agent for the purposes of Section 42 and gives a wide range of selection. In the third place, it is laid down in Section 42 that the agent shall be deemed to be the assessee, a provision which was absent in 5 and 6 Vict. We shall have occasion to refer to this provision at a later stage.

We have not been referred to any authority based on the English Act of 1818 and, in any case, having examined Section 101 of the Act and rules 5 and 13 of the Central Rules passed thereunder, we do not think that the position is affected. We are clearly of opinion that the question before us must be decided by reference to the provisions of the Indian Act alone, and we would hesitate to draw any support from foreign authorities based on the English law.

It has been held on several occasions by various Courts that Section 40 and the following sections are "machinery" or enabling sections. Chapter V, which contains these sections, is headed "Liability in Special Cases" and some argument might perhaps be based on the language of this heading, but we do not think that it is necessary to pursue this point. We will assume that Section 42 is a "machinery" section.

Now, Section 4 (1) of the Act provides:

"Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived accruing or arising, or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British India."

Section 6, which is a charging section, lays down that "Save as otherwise provided by this Act, the following heads of income, profits and gains, shall be chargeable to income tax in the manner hereinafter appearing....."

Now we come to Chapter V. Section 40 deals with the guardian, trustee or agent of a minor, lunatic or idiot or of a person residing out of British India and provides that tax shall be levied upon and recoverable from such guardian, trustee or agent, being in receipt on behalf of the beneficiary of any income, profits or

in like manner and to the same amount as it would be leviable upon and recoverable from any such beneficiary if of full age, sound mind, or resident in British India, and in direct receipt of such income, profits or gains. Non-residents are again dealt with, specifically and in detail, in Section 42. Section 42 (1) reads as follows :—

In the case of any person residing out of British India, all profits or gains accruing or arising to such person, whether directly, or indirectly, through or from any business connection or property in British India, shall be deemed to be income accruing or arising within British India, and shall be chargeable to income-tax in the name of the agent of any any such person, and such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax ; Provided that any arrears of tax may be recovered also in accordance with the provisions of this Act from any assets of the non-resident person which are, or may at any time come within British India.

Section 43 provides that :

“ Any person employed by or on behalf of a person residing out of British India, or having any business connection with such person, or through whom such person is in the receipt of any income, profits or gains upon whom the Income-tax Officer has caused a notice to be served of his intention of treating him as the agent of the non-resident person shall, for all the purposes of this Act, be deemed to be such agent :

Provided that no person shall be deemed to be the agent of a of a non-resident person, unless he has had an opportunity of being heard by the Income-tax Officer as to his liability.”

It will be seen that the word “ agent ” for the purposes of Section has a wider scope than it has in ordinary use. The first thing which falls to be considered is the significance to be attached, in the light of Section 42 (1) to the words “ shall be chargeable to income-tax in the manner hereinafter appearing ” in Section 6 ; that is to say, we have to consider what is the “ manner hereinafter appearing as regards a non-resident. Section 42 provides the method of charging a non-resident and lays down that in circumstances such as we are now dealing with, profits and gains of the non-resident shall be chargeable to income-tax in the name of the agent and that

‘ such agent shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income-tax.’

“ Assessee ” is defined in Section 2 (2) as the person by whom income tax is payable. It is thus only the assessee who can be called upon to pay income-tax. The only construction which we can place on the language of Section 42 (1) is that the agent alone and not his non-resident principal shall for the purposes of the Act be treated as the assessee, *i.e.*, as the person to whom a notice under Section 22 (2) shall issue and by whom the tax is payable.

The word "shall" in Section 42 (1) is significant; it shows that the provisions of that section are mandatory, and in our opinion the department is precluded from issuing notices to the principal and from treating the principal as the assessee except to the limited extent that any arrears of tax may also be recovered from assets of his which may be found in British India. If the Legislature had intended that the principal also might be treated as the assessee, one would have expected to find the word "may" instead of "shall" or the Legislature might have inserted a provision investing the non-resident principal also with the character of assessee, if he could be got at, in the same way as it has provided for the recovery of arrears of tax from the assets of the principal in British India. When the agent in British India is invested with the character of assessee in the mandatory terms which we find in Section 42 (1) and to the apparent exclusion of the principal, it would seem to follow that the non-resident principal is divested of that character.

In certain English cases it was argued that the provision as regards liability of the resident agent was enacted by the Legislature to assist the income-tax authorities in collecting the tax and was not intended to alter the incidence of taxation. That argument might have considerable force with reference to the law prevailing in England, but we have formed our opinion in this case on the language of the relevant sections of the Indian Act and on the imperative phraseology of the provisions of Section 42 (1).

It appears to us that in the case of a person residing out of British India who has property or business connexions in British India the income tax authorities are not competent to serve notices upon him; such notices must be served upon his agent in British India or upon such person as may be deemed to be his agent within the meaning of Section 43 and who will be treated as such. The Proviso to Section 42 does not, to our minds, militate against the view that we have taken and does not support the opinion of the Commissioner that it is open to the Income tax Officer to address notices direct to the assessee even though he be a "non-resident". With all respect to the learned Judges of the Madras High Court who decided 44 Mad. 778 we do not agree that the Proviso to Section 42 in any way goes against the construction that the income of a non-resident shall be chargeable to income-tax in the name of the agent. The Proviso contemplates the possibility of the assessee, *i.e.*, the agent, not being able to pay the income-tax. It is only natural to suppose that the non-resident will place the agent in funds in order to enable him to pay the the income-tax demand, but if the agent is not provided with such funds, then, apart from such steps as might be taken against the agent, the Proviso empowers the authorities to recover the tax from the assets of the non-resident in British India, and in the majority of cases the non-resident will have such assets in British India because the income which has accrued to him has accrued to him through or from some business

connexion or property in British India, and even if in some extraordinary case there be no such assets for the time being, the authorities are empowered to seize any assets when they come at any future time in British India. That, in our opinion, is the only effect of the Proviso which does not override the mandatory provisions contained in the preceding paragraph that the income shall be chargeable to income-tax in the name of the agent.

We answer question No. 2 in the affirmative. Learned counsel for the Maharaja informed us that in this view of the case he does not want us to answer Questions Nos. (1) and (3) so far as the present assessment is concerned, and as counsel for the Department does not insist that the said questions should be answered, we refrain from expressing any opinion on them. Let a copy of our judgment be sent to the Commissioner under the seal of the Court and the signature of the Registrar. The hearing of the case lasted for more than a day and counsel for the Department is allowed six weeks within which to file the certificate. We fix his fees at Rs. 200.

Reference answered accordingly.

[IN THE CALCUTTA HIGH COURT.]

HIMALAYA ASSURANCE CO. LTD., *In re.*

SIR HAROLD DERBYSHIRE, C.J., KHUNDKAR, J., and

MUKHERJEA, J.

January 11, 1938.

INSURANCE COMPANY—MODE OF ASSESSMENT—ACTUARIAL BALANCE SHEET SHOWING DEFICIT BUT LESS DEFICIT THAN PREVIOUS BALANCE SHEET—ANNUAL AVERAGE OF SURPLUS, WHETHER ASSESSABLE AS PROFIT—INCOME TAX DEPARTMENT WHETHER ENTITLED TO GO BEHIND ACTUARIAL VALUATION—MEANING OF RULE 25, INDIAN INCOME TAX RULES.

The actuarial valuation of a life insurance company in respect of the quinquennium which ended on the 28th February 1935 showed a life assurance fund of Rs. 3,78,138, a net liability of Rs. 4,91,628 and a deficit of Rs. 1,13,490; and in accordance with this valuation, for the assessment year 1936-37, the company made a return showing a loss of Rs. 22,698, being one-fifth of the said deficit. The valuation for the previous quinquennium showed a net

deficit of Rs. 2,08,228 and the Income-tax Officer assessed the company on a profit based on the annual average of the surplus of Rs. 94,738 (Rs. 2,08,228 minus Rs. 1,13,490) shown in the second valuation on the ground that in order to arrive at the annual average referred to in Rule 25 of the Income Tax Rules adjustment must be made for the surplus or the deficit, as the case may be, shown in the previous valuation which is carried forward in the next valuation :

Held, on a reference by the Commissioner, that the 'net profits' referred to in Rule 25 mean the 'surplus, if any, in the statutory form of valuation balance sheet, of 'life assurance and annuity funds' over 'the net liability under life assurance and annuity transactions,' and the income tax department was not entitled to go behind the said valuation balance sheet to find out if there were any profits in respect of the period of the last preceding valuation.

BHARAT INSURANCE CO. LTD. v. COMMISSIONER OF INCOME TAX, PUNJAB [1934] (1934 I.T.R. 68; 61 I.A. 41; I.L.R. 15 Lah. 224; 7 I.T.C. 151) referred to.

Case stated by the Commissioner of Income-tax, Bengal, under Section 66 (2) of the Income Tax Act, (XI of 1922). The facts of the case and the opinion of the Commissioner appear from the following statement of case made by the Commissioner.

STATEMENT OF CASE.

"At the request of the assessee, the Himalaya Assurance Company Limited, the following statement of case is drawn up and submitted for the decision of their Lordships under Section 66 (2) of the Income tax Act.

Facts of the Case.—The assessee is a life assurance company, incorporated in British India. For the assessment year 1936-37 it submitted a return showing a loss of Rs. 22,698. The Income tax Officer however, made an assessment on an income of Rs. 26,803 arrived at in the manner described below.

3. The last preceding valuation on the basis of which the assessment has been made is the quinquennium ended the 28th February, 1935. The result of the actuarial valuation as at 28th February, 1935, is a deficit of Rs. 1,13,490 computed as below :—

Life Assurance Fund as at 28th February, 1931	4,78,138
Net liability	4,91,028
Deficit	1,13,490

The figure shown against Life Assurance Fund as at 28th February 1935, is the result of the Life Assurance Fund as at the valuation for the period ended 28th February 1930 plus incomes and receipts arising within the quinquennium ended 28th February

1935 less claims and expenses paid and incurred in the quinquennium ended 28th February 1935. The net liability figure mentioned above is again the net liability as shown in the actuarial balance sheet as at 28th February 1930 *plus* the net liability in respect of new policies introduced in the quinquennium ended 28th February 1935 less the net liability in respect of those policies which were in force on 28th February 1930 but which ceased within the quinquennium ended 28th February 1935. The net liability figure mentioned above includes all the elements which were included in the net liability as at 28th February 1930 less elements in respect of policies which ceased within the quinquennium ended 28th February 1935. To make matters clear I give below the relevant figures in respect of the period ended 28th February 1930 as well as those of the period ended 28th February 1935 :—

	Rs.
Life Assurance Fund as at 28th February 1930	1,09,415 (A)
Net liability as at 28th February 1930	3,17,643 (B)
Deficiency	2,08,228 (C)
Life Assurance Fund as at 28th February 1935	3,78,138 (D)
Net liability as at 28th February 1935	4,91,628 (E)
Deficiency	1,13,490 (F)

Deficiency (C) which is a part of the liability (B) has automatically found its way into the net liability (E). This process will continue till the fund increases to such an extent as to exceed the liability when only the actuarial valuation will show a surplus and not before. The actuarial balance sheet on a given date is the result of the operation of the company from its very inception and not of any intermediate period only. Therefore to find out the result of a particular period of valuation the result of the earlier period has to be eliminated. So far as the period under discussion, that is the quinquennium ended 28th February 1935 is concerned, the elimination has to be done in the following manner :—

	Rs.	Rs.
Fund on 28th February 1935	3,78,138	
Less—Fund on 28th February 1930 included in above	1,09,415	
Difference is the net addition to fund in the period of 5 years ended 28th February 1935.		2,68,723 (a)

Net liability as on 28th February 1935.	4,91,628
<i>Less</i> —Net liability as on 28th February 1930.	3,17,648
Net liability addition in the 5 years ended 28th February 1935.	1,73,985 (b)
Difference between (a) and (b) is the surplus made in the quinquennium ended 28th February 1935.	94,738

The Income Tax Officer took this figure Rs. 94,738 as the surplus in the circumstances detailed above. To this he added back the following :—

	Rs.
Reserve for bad debt	2,065
Loss on sale of motor car	84
Preliminary expenses written off	20,000
Income-tax on interest on securities	19,757
	1,36,644
<i>Less</i> —Income-tax refund credited to consolidated revenue account.	2,680
Balance	1,34,014

(or the quinquennium) Annual average 26,808
the figure on which the assessment under discussion has been made as stated before. The assessee has contended that even though in a certain period the company may have made a surplus, Rule 25 under which the income is to be computed precludes the Income Tax Officer from considering that surplus independently and that assessment proceedings cannot be started unless the results of the actuarial valuation at the end of a period disclose a positive figure. The assessee then appealed to the Assistant Commissioner of Income-tax who upheld the assessment.

4. Arising out of these facts and circumstances the assessee formulated the following four questions of law :—

(a) Whether reduction of quantum of deficiency revealed by the valuation of 1935 is profit of the quinquennium ending 1935 as contemplated by Rule 25.

(b) Whether the Assistant Commissioner was justified in saying that the deficiency of the valuation of 1935 (*sic*—should be 1930) was carried over in arriving at the valuation of 1935,

(c) Whether Rule 25 contemplates an assessment of a Life Assurance Company when the Company's actuarial valuation reveals a deficiency.

(d) Whether the terms "income, profits and gains," as contemplated in Rule 25 connote an actuarial valuation surplus.

But in my opinion the real point at issue that arises in this case may be covered by a single question formulated as below.

"The assessee's actuarial valuation Balance Sheet on the last date of the last preceding valuation having shown a deficiency, does the provision of Rule 25 of the Rules under the Income-tax Act for ascertaining the average annual net profits of a Life Assurance Company permit the department to go behind the said valuation Balance Sheet to find out if there were any profits in respect of the period of the last preceding valuation?"

Instead of referring the questions as framed by the assessee I beg to refer the above question only for their Lordships' decision.

5. Opinion of the Commissioner.—The words "annual average" in Rule 25 are very significant. "Average" in the present matter connotes the figure which is arrived at by dividing the aggregate of the figures of the number of years in a period by the number of such years. In the present case, the period is of five years. The result of the actuarial valuation of a life assurance company as disclosed in the actuarial accounts at the end of a given period is really a continuation of previous valuation, and adjustment must necessarily be made to find out what really is the surplus or deficit of a given period (in this case, a quinquennium) in order to determine the assessability or otherwise of the company in terms of Rule 25. If the result of the valuation of a period preceding the period which is made the basis of an assessment is a surplus, such portion of that surplus as has not been appropriated by way of bonus, etc., automatically comes to be merged in a subsequent valuation and unless such unappropriated surplus is taken out of the next valuation results, there will obviously be double taxation of some income. Similarly, if the result of the valuation of a period preceding the valuation which is made the basis of assessment of a given year is a deficit, such deficit will automatically find its way into the next valuation. To arrive at the annual average net profit, adjustment will therefore have to be made to avoid the results as above stated and such adjustment is accordingly permissible by Rule 25. After these adjustments have been made, the result of the period (in this case a quinquennium) be it profit or loss is ascertained and one-fifth of such result should be the annual average for the purpose of Rule 25. From the manner in which the computation of the sum of Rs. 94,738 has been made, I would respectfully submit that the actuarial valuation really disclosed a positive surplus. The term 'disclosed' as used in Rule 25 loses, in my opinion, all its force and meaning if the method of computation

as employed here is to be eschewed altogether. Moreover, such a surplus is not the result of the jugglery of figures. From the consolidated revenue account for the period ended 28th February 1935 it is found that a sum of Rs. 2,06,449 has been shown as profit on sale of investments. From the figures given in paragraph 3 it will be seen that there was a deficiency of Rs. 2,08,228 at the end of the quinquennium ended 28th February 1930. At the end of the quinquennium ended 28th February 1935 there was a deficiency of Rs. 1,13,490. For this reduction in deficiency there must be a tangible cause and the only cause as far as is apparent is the profit made on the sale of investments. In the circumstances of the case, I would respectfully submit that their Lordships may be pleased to hold that the answer to the question formulated in paragraph 4 is in the affirmative.

6. I append to the statement of case copies of the following documents :—

(A) Consolidated Revenue account for the quinquennium ended 28th February 1930. (B) Consolidated Revenue account for the quinquennium ended 28th February 1933. (C) Assessment Order. (D) Grounds of Appeal. (E) Appellate Order. (F) Application under Section 66 (2).

S. N. Banerjee and A. C. Sen for the Assesseees.

The Advocate-General, Radhabinod Pal and Romesh Chandra Pal for the Commissioner of Income Tax.

JUDGMENT.

DERBYSHIRE, C. J.—The facts of this case are set out fully in the case stated by the Commissioner of Income-tax. The question asked is :

“ The assessee's actuarial valuation balance sheet on the last date of the last preceding valuation having shown a deficiency, does the provision of Rule 29 of the rules under the Income Tax Act for ascertaining the average annual net profits of a Life Assurance Company permit the department to go behind the said valuation balance sheet to find out if there were any profits in respect of the period of the last preceding valuation ? ”

It appears to me that the matter is concluded by the judgment of the Privy Council in the case of *Bharat Insurance Company, Limited v. Commissioner of Income Tax*. At page 43 (of 61 I.A.) **SIR JOHN WALLIS** said : “ Under the provisions of Sections 5 & 6 of the Indian Life Assurance Companies Act, 1912, the company's life assurance business has to be kept entirely separate from its other businesses if any, and under Sec. 8, Sub-section (1), it is obliged to have a quinquennial valuation made by an actuary and to cause an abstract of the report of such actuary to be made in the form set forth in the fourth Schedule to the Act,

"The form of the resulting valuation balance sheet is to be found at the end of the fourth schedule of the Act and is as follows :

Valuation Balance Sheet of		As at	19
Dr.	Cr.		
	Rs.		Rs.
To net liability under life assurance and annuity transactions (as per summary statement provided in fourth schedule)		By life assurance and annuity funds (as per balance sheet under third schedule) ...	
To surplus if any	—	By deficiency, if any	

".....Under Rule 25 made under Section 59 of the Indian Income Tax Act, 1922 : 'the income, profits and gains of a life assurance business shall be the average annual net profits disclosed by the last preceding valuation'; that is to say, shall be arrived at by taking one-fifth of the surplus disclosed in the valuation balance-sheet already mentioned and treating it as the average annual income of the business for the next quinquennium".

That statement is emphasised at page 49 of the report as follows: "The 'net profits' in this rule clearly mean the 'surplus if any' in the statutory form of valuation balance-sheet set out above, of 'life assurance and annuity funds (as per balance-sheet under third schedule)' over the 'net liability under life assurance and annuity transactions (as per summary statement provided in fourth schedule)'".

In my view that clearly states what the legal position is in this case and the answer to the question asked by the Commissioner of Income tax must be in the negative.

The assessees will have the taxed costs of this Reference.

KHUNDKAR, J.—I agree.

MUKHERJEE, J.—I agree.

Question answered in the negative.

[IN THE CALCUTTA HIGH COURT.]

MOOLJI SICKA, *In re.* [No. 2].

SIR HAROLD DERBYSHIRE, C. J., KUNDKEAR, J., and

MUKHERJEA, J.

January 12, 1938.

SUCCESSION—FIRM—CHANGE IN SHARES WITHOUT CHANGE IN PERSONNEL OF PARTNERS—WHETHER ‘CHANGE IN THE CONSTITUTION OF THE FIRM’—ASSESSMENT OF PARTNER—BASIS—SHARE DURING ACCOUNT YEAR OR ASSESSMENT YEAR—INDIAN INCOME TAX ACT (XI OF 1922), SECTION 26 (1).

The words ‘change in the constitution of a firm’ in Section 26 (1) of the Indian Income Tax Act mean a change in the persons who are partners in the firm and not a mere change in the proportion in which the partners divide the profits.

During the year of account the assessee’s share in a firm was 11/89. At the close of that year, i.e., before assessment, a fresh deed of partnership was executed between the same partners under which the assessee became entitled to a 11/30 share in the profits. Held, on a reference made by the Commissioner, that as there was no change in the personnel of the firm but only a change in the share of profits there was no change in the constitution of the firm within the meaning of Section 26 (1) of the Act, and assessment must, therefore, be made on the basis of the share which the assessee had during the accounting year.

Case stated by the Commissioner of Income tax, Bengal, under Section 66 (2) of the Indian Income tax Act, 1922. [Civil Reference No. 6 of 1937].

The facts of the case, the question referred and the opinion of the Commissioner appear in the following statement of the case made by the Commissioner.

STATEMENT OF CASE.

“At the request of the assessee, the following statement of case is drawn up and submitted for the decision of Their Lordships under Section 66 (2) of the Income tax Act on the question of law formulated in paragraph 6 below. By a petition submitted on the 9th August 1937 it has been prayed that a reference may be submitted to the Hon’ble High Court for the years 1932-33, 1933-34

and 1934-35 and that the decision of Their Lordships on that reference may be followed in respect of the assessment year 1935-36 for which it has been prayed that no separate reference need be sent up.

2. Facts of the Case.—The assessee is a partner in the registered firm of Messrs. Moolji Sicka and Company which has been treated as a registered firm for a number of years in the past. The facts so far as the point at issue in this case is concerned are that Moolji Sicka has been assessed for the assessment years 1932-33, 1933-34 and 1934-35 on his share of the partnership income. There was no other income in the 1932-33 assessment of the assessee; for the assessment year 1933-34 there was some loss under the head 'other sources'. In 1934-35 besides the partnership income there was some income from house property. The accounting year in respect of the assessment year 1932-33 is 1937-88 Dewali corresponding to the year ended October, 1931. For the assessment years 1933-34 and 1934-35 the accounting years are 1938-89 Dewali and 1939-90 Dewali corresponding respectively to the years ended October 1932 and October 1933. For the assessment year 1932-33 an application for registration was filed by the firm before the Income Tax Officer on the 26th July 1932. This application is reproduced below :—

“Form of application for registration of the firm under Section 2 (14) of the Indian Income tax Act, 1922.

To The Income tax Officer,
District V, Calcutta.
Dated, 26th July, 1932.

1. We, Messrs. Moolji Sicka & Co., beg to apply for renewal of registration of our firm under Section 2 (14) of the Indian Income tax Act, 1922.

2. The original of the instrument of partnership under which the firm is constituted specifying the individual shares of the partners together with a copy is enclosed. The prescribed particulars are given below.

3. We do hereby certify that the profits for the previous year have been actually divided or credited in accordance with the shares shown in this partnership deed.

Signature (In vernacular)

Address () ”

Name and address of the firm.	Names of the partners with shares.	Date on which the instrument was executed.	Date on which the instrument of partnership was first registered with the I.T.O.
Messrs. Moolji Sicka & Co., 51, Ezra St. Calcutta.	(1) Bhai Moolji Sicka As. 0-5-6 (2) Bhai Purshottam Sicka. As. 0-4-6 (3) Bhai Kalyanji Vithaldas. As. 0-3-6 (4) Bhai Kanji Mulji As. 0-2-0 (5) Bhai Chaturbhuj Vithaldas As. 0-2-0 (6) Bhai Champsey Vithaldas As. 0-1-0 (7) Bhai Shivasdas Moolji As. 0-1-0	11th Sept. 1930	1931-32 Assessment

I, Kanjee, do hereby certify that what is stated hereinabove is true to my knowledge, belief and information.

Sd. (In vernacular).

The form of application for registration is one which is prescribed by Rule 3 of the rules under the Act which have under Section 59 (5) of the Income Tax Act the force of law. The application as reproduced above was not in accordance with the prescribed form inasmuch as the prescribed form directs that the applicant should certify that "the profits of the current year will be actually divided or credited" while the above application certified that "the profits for the previous year have been actually divided or credited". The Income tax Officer took exception to the application in this form whereupon the assessee filed another application on the 21st November 1932 in the prescribed form certifying "that the profits of the current year will be actually divided or credited in accordance with the shares shown in this partnership deed". The prescribed particulars required by paragraph 2 of the form of application as submitted with

the application filed on the 21st November 1932 are given below :

Name and address of the firm.	Names of the partners in the firm with the share of each in the business.	Date on which instrument of partnership was executed.	Date if any, on which the instrument of partnership was last registered in the Income Tax Officer's Office.
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Messrs.			
Molji Sicka & Co.,	Mooljee Sicka, As. 0-5-6.		
51, Ezra St. Calcutta.	Purshottam Sicka As. 0-2-3 Kalyanjee Vithaldas, As. 0-1-9 Kanji Moolji As. 0-3-0 Chaturbhuj Vithaldas, As. 0-0-6 Champsey Vithaldas, As. 0-1-0 Shivdas Moolji, As. 0-1-0	17th December, 1931.	
	Total As. 0-15-0		

We, do hereby certify that the information given above is correct.

Signature (s) (In vernacular).

For the assessment year 1933-34 an application for registration was filed on the basis of a deed dated the 6th March 1934 specifying the shares of the partners and certifying that the profits of the current year would be actually divided or credited in accordance with the shares shown in this partnership. For the assessment year 1934-35, a similar application was filed on the basis of the partnership deed dated the 6th March 1934 and with the same certificate as for the assessment year 1933-34. The Income tax Officer has made the assessments on the assessee on the basis of the share the assessee held at the time of making the assessment while the assessee argues that the Income tax Officer should have made the assessment not on the partners who were before him at

the time of the assessment and on the shares held at the time of the assessment, but that he should have assessed the partners who were partners during the accounting period and on the shares which they had in the accounting period and not at the time of the assessment. According to him, the provisions of Section 26 (1) of the Income tax Act should not be held to be applicable as no change in the constitution of the firm took place. It is also asserted that this section is not applicable if only the respective shares of the partners change but not the personnel.

3. The total incomes of the registered firm for the years 1932-33 to 1934-35 as assessed are given below—

1932-33	Rs. 4,91,952
1933-34	... 6,65,442
1934-35	... 7,23,724

The share of this income as allocated by the Income Tax Officer to the assessee is—

1932-33	Rs. 1,60,602
1933-34	... 2,60,480
1934-35	... 2,68,901

Moolji Sicka (the assessee) had 5 annas 6 pies share in each of these years, but this 5 annas 6 pies was out of a total of 19 annas 6 pies in respect of the 1932-33 assessment, and out of a total of 15 annas in respect of the assessments for the years 1933-34 and 1934-35.

4. The facts relating to the assessment year 1932-33 are different from those relating to the assessment years 1933-34 and 1934-35 as will be found from what is stated below :—

Year of assessment—1932-33.

Date of assessment	... 2nd December 1932.
Accounting year	... 1937-38 Dewali.
Corresponding to the year ended	... October, 1931.

During the accounting year, the shares of the partners were based on a partnership deed dated 11th September 1930 while the shares at the time of the assessment are those of the partnership deed dated 17th December 1931 which was executed to take effect from October 1931. The shares of the respective partners during the accounting year are shown below against the shares which the partners had at the time of assessment,—

Names.	Shares during the accounting year.			Shares at the time of making the assess- ment.		
	Rs.	A.	P.	Rs.	A.	P.
1. Moolji Sicka.	0	5	6	0	5	6
2. Purshottam.	0	4	6	0	2	3
3. Kalyanji.	0	3	6	0	1	9
4. Kanji Moolji.	0	2	0	0	3	0
5. Chaturbhuj Vithaldas.	0	2	0	0	0	6
6. Sewdas Moolji.	0	1	0	0	1	0
7. Champsi Vithaldas.	0	1	0	0	1	0
Total	1	3	6	0	15	0

Moolji Sicka owned 5 annas 6 pies share out of 19 annas 6 pies during the accounting period while at the time of assessment his share being 5 annas 6 pies out of the total of 15 annas, was higher than what it was in the year of account.

Year of assessment—1933-34.

Date of assessment	... 27th June 1934.
Accounting year	... 1938-39 Dewali.
Corresponding to the year ended	... October 1932.

During the year of account the shares of the partners were as per the partnership deed dated the 17th December 1931. One of the partners, *viz.*, Purshottam died on 5th December 1933 and a fresh partnership deed dated the 6th March 1934 was executed and was to take effect from the 5th December 1933. The statement below gives the names and shares of the parthers during the period of account and at the time of assessment.

Names and shares during the accounting year.			Names and shares at the time of making the assessment.		
	A.	P.		A.	P.
1. Moolji Sicka ...	5	6	Moolji Sicka ...	5	6
2. Purshottam ...	2	3	Udhavji ...	0	6
3. Kalyanji ...	1	9	Kalyanji ...	1	9
4. Kanji Moolji ...	3	0	Kanji Moolji ...	3	0
5. Chaturbhuj Vithaldas	0	6	Chaturbhuj Vithaldas...	0	6
6. Sewdas Moolji ...	1	0	Sewdas Moolji ...	1	0
7. Champsi Vithaldas...	1	0	Champsi Vithaldas ...	1	0
Total.	15	0	Total.	13	3

Year of Assessment—1934-35.

Date of Assessment ... 27th February, 1935.
Accounting year ... 1939-40 Dewali.
Corresponding to the year ended ... October 1933.

Names and shares during the accounting year and names and shares at the time of making the assessment are the same as shown under 1933-34.

5. It will be seen from a comparison of what has been noted above that for the assessment year 1932-33 there has been change only in the extent of the shares as between the year of account and the year of assessment, while for the years 1933-34 and 1934-35 there has been change both in the extent of the shares as well as in the personnel. The Income-tax Officer in making the assessments proceeded under Section 26 (1) of the Act on the basis of the changes thus revealed at the time of making the assessments.

6. Arising out of these circumstances the assessee formulated the following question for reference to the Hon'ble High Court under Section 66 (2) of the Income Tax Act:—

“Whether in the circumstances of the case, when actual total income in fact earned by the assessee in the previous year is found, it is lawful to invoke the aid of Section 26 (1) of the Act and to assess on an enhanced total income which was never earned by the assessee.”

In my opinion the question is not happily framed and does not also raise clearly the real question at issue. Instead of referring this question I am substituting the following question:—

“Whether in the facts and circumstances stated above and on the true construction of Sec. 26 (1) of the Indian Income Tax Act (XI of 1922) the assessee should be chargeable to tax on the basis of his share at the time of making the assessment or on the basis of the share which he had during the accounting year?”

and I respectfully submit this question for the decision of Their Lordships.

7. **Opinion of the Commissioner.**—It has been argued on behalf of the assessee that partnership being the relation between persons who have agreed to share the profits of a business (Section 4 of the Indian Partnership Act (IX of 1932), unless there is change of persons it cannot be held that there has been change in the constitution such as is contemplated in Section 26 (1) of the Income Tax Act. It will be seen from the facts stated above that formerly there was a deed dated the 11th September 1930. It was on the basis of this deed that assessments prior to 1932-33 were

made. The partners found it necessary to make a fresh deed on the 17th December 1931 to take effect from October 1931. It was because they found that the relation between the persons forming the partnership had undergone a change that it was necessary to make a fresh deed giving effect to this changed relation whereby some of the partners were given larger shares. After this deed of the 17th December 1931 one of the partners, *viz.*, Purshottam died and in the next partnership deed which was drawn, *viz.*, the one dated the 6th March 1934 there had been change not only of the shares of the partners but of persons also, for Udhavji, the only son of Purshottam, was substituted with a different share. I do not see in the facts of the case that there is any difficulty in holding that there has been change in the constitution of the firm or that a firm had been newly constituted. The fact that the partners felt the necessity for making fresh partnership deeds, *viz.*, dated the 17th December 1931 and 6th March 1934 goes to show that change had occurred in the constitution of the firm and that the firm had been newly constituted within the meaning of Section 26 (1) of the Act. I therefore respectfully submit that the department has rightly applied Section 26 (1) of the Act to the assessments under discussion and rightly held that each partner had received the share of the profits of the previous year proportionate to his interest in the firm at the time of making the assessment. I would therefore respectfully submit that Their Lordships may be pleased to answer the reference in favour of the revenue.

8. - I append to the statement of case copies of the following documents: (A) Assessment Order. (B) Grounds of Appeal. (C) Appellate Order. (D) Application under Section 66 (2).

Dr. S. C. Roy, for the Assessee.

Advocate General of Bengal, Dr. Radhabinod Pal, and Mr. R. C. Pal, for the Commissioner.

JUDGMENT.

DERBYSHIRE, C.J.—The facts are fully stated in the case, but shortly are as follows :—

Babu Moolji Sicka was a member of a trading partnership. During the accounting year which was October 1930 to October 1931 the assessee's share of the profits of the firm was 11/39. After the accounting year, namely, on December 17th, 1931, the partners agreed in a deed that the assessee's share of the profits of the firm should henceforward be 11/30. The partners remained the same, but their respective shares in the profits were altered.

The assessment year was April 1932 to March 1933, and the deed referred to was in operation during the year of assessment. The assessment was made on December 2nd, 1932.

The question is whether in the facts and circumstances stated and on the true construction of Section 26 (1) of the Indian Income-tax Act, the assessee should be chargeable to tax on the basis of his share of the profits at the time of making the assessment on the basis of the share of the profits which he had during the accounting year. If Section 26 (1) applies then the assessee would be chargeable to tax on the basis of his share of the profits at the time of making the assessment. That share was of course greater than during the accounting year. Section 26 (1) reads :

“Where, at the time of making an assessment under Section 23, it is found that a change has occurred in the constitution of a firm or that a firm has been newly constituted, the assessments on the firm and on the members thereof shall, subject to the provisions of this Act, be made as if the firm had been constituted at the time of making the assessment, and as if each member had received a share of the profits of that year proportionate to his interest in the firm at the time of making the assessment”.

There is no question here of a firm having been newly constituted. The only question is whether a change has occurred in the constitution of a firm. There is no previous decision to guide us as to the meaning of ‘change in the constitution of a firm’. The relevant explanation of the word ‘constitution’ given in the *The New English Dictionary* by Sir James Murray, Vol. II, page 876 is “The way in which anything is constituted or made up; the arrangement or combination of its parts or elements, as determining its nature and character; make, frame, composition”. From a consideration of that definition a “change in the constitution of a firm” would suggest a change in its partners but not a change in the proportion in which the partners divided the profits. Some help is obtained from the provisions of the Partnership Act, 1932. Section 17 (a) of that Act says:—

“Subject to contract between the partners where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the re-constituted firm remain the same as they were immediately before the change, as far as may be”

Section 38 provides :

“A continuing guarantee given to a firm or to a third party in respect of the transactions of a firm is, in the absence of

agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm ”.

Section 63 (1) enacts :—

“ When a change occurs in the constitution of a registered firm any incoming, continuing or outgoing partner and when a registered firm is dissolved any person who was a partner immediately before the dissolution, or the agent of any such partner or persons specially authorised in this behalf, may give notice to the Registrar of such change or dissolution, specifying the date thereof ; and the Registrar shall make a record of the notice in the entry relating to the firm in the Register of Firms, and shall file the notice along with the statement relating to the firm filed under Section 59 ”.

Section 17 does not appear to help in arriving at a meaning of the phrase ‘ change in the constitution of a firm ’, but Sections 33 and 63 where they mention the phrase ‘ change in the constitution of a firm ’ are, it seems to me, referring to a change in the personnel of the firm, that is, a change in the persons who are partners in the firm.

In my opinion, there was no change in the constitution of the firm on December 17th, 1931, within the meaning of Section 26 (1) of the Indian Income Tax Act. Consequently, Section 26 (1) has no application to this particular case. The result is that the assessment must be made on the basis of the share which the assessee had during the accounting year. With regard to the years subsequent to the year of assessment 1932-33, the matter has not been pressed and the question does not arise.

The assessee will get half the ordinary costs of the Reference.

KHUNDKAR, J.—I agree.

MUKHERJEA, J.—I agree.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

GOPINATH VIR BHAN

v.

COMMISSIONER OF INCOME-TAX, PUNJAB.

SIR JAMES ADDISON and DIN MOHAMMED, JJ.

January 6, 1938.

BUSINESS EXPENDITURE—STIPULATION TO PAY SHARE OF PROFITS IN ADDITION TO ORDINARY CHARGES FOR WORK DONE

—SHARE OF PROFITS PAID, WHETHER DEDUCTIBLE AS BUSINESS EXPENDITURE OR RENT OF PREMISES—FLUCTUATING AMOUNT, WHETHER CAN BE RENT—INDIAN INCOME TAX ACT (XI of 1922), SEC. 10 (2) (i) and (ix).

The assessee entered into an agreement with a company by which he agreed to get all the raw cotton purchased by him ginned by the company and the company agreed not to do ginning or pressing for any other customer. In addition to ginning charges at certain rates the assessee agreed to pay to the company as additional ginning charges one-third of the net profits earned by him in his cotton and seed business after deducting all expenses connected with the sale and purchase of cotton and seed. In the case of loss no sum was to be paid to the company nor was the company bound to make any contribution on that account. In the accounting year the assessee paid to the company Rs. 68,000 odd towards ginning charges and Rs. 22,429 towards one-third of the net profits in accordance with their agreement :

Held, on a reference by the Commissioner, that the sum of Rs. 22,429 paid by the assessee to the company was not a legitimate deduction under Section 10 (2) (i) of the Indian Income-tax Act inasmuch as a fluctuating item like a share in the profits cannot be treated as rent within the meaning of Section 10 (2) (i) ; it was also not deductible under Section 10 (2) (ix) as the payment was a payment out of the profits after they had been earned and not an expenditure incurred for earning the profits.

Held also, that the question, whether an advance made by a partner is a loan to the partnership or an increase in the capital of the firm is a question of fact and if the income tax authorities have held that it was by way of an increase in the capital and not a loan independent of the partnership capital, the High Court cannot interfere with the finding.

Cases referred to :

INDIAN RADIO AND CABLE COMMUNICATIONS v. COMMISSIONER OF INCOME TAX, BOMBAY [1937] (5 I.T.R. 270; I.L.R. 1937 Bom. 591).

PONDICHERRY RAILWAY Co. v. COMMISSIONER OF INCOME TAX, MADRAS [1931] (58 I.A. 289; 5 I.T.C. 363; 54 Mad. 641).

TATA HYDRO ELECTRIC AGENCIES LTD. v. COMMISSIONER OF INCOME TAX, BENGAL [1937] (5 I.T.R. 202; 64 I.A. 215; 1937 A.C. 212; 106 L.J.P.C. 102).

UNION COLD STORAGE COMPANY v. ADAMSON [1931] (16 Tax Cas. 208; 146 L.T. 172).

Case stated by the Commissioner of Income Tax, Punjab, and N. W. F. P. under Section 66 (3) of the Indian Income Tax Act (XI of 1922) in the matter of the assessment of Gopinath Vir Bhan for the assessment year 1935-36. [Civil Reference No. 23 of 1937].

The facts of the Case, the questions referred and the opinion of the Commissioner appear in the following Statement of Case submitted by the Commissioner.

STATEMENT OF CASE.

" Statement of case under Section 66 (3) of the Indian Income Tax Act, as ordered by the Hon'ble Judges of the Lahore High Court in Civil Miscellaneous No. 88 of 1937, arising out of the assessment for 1935-36 of Messrs. Gopinath-Virbhan, of Chich-watni, under Section 23 (3).

Facts of the Case.—For the year 1935-36, the Income Tax Officer assessed Messrs. Gopinath Virbhan on the footing of an association of individuals on a total income of Rs. 77,991. A copy of the assessment order is annexed (Exhibit A). The source of income of the assessee is cotton business. The super-tax demand was subsequently found by the Income Tax Officer to have been wrongly calculated and the mistake was rectified by him under Section 35 of the Act. At the time of the assessment the assessee applied for registration as a firm under Section 26-A on the basis of a partnership deed, dated 27th January, 1934, written in Urdu. An English translation of the partnership deed is annexed (Exhibit B). The Income tax Officer rejected the application for registration but on appeal the Assistant Commissioner allowed registration of the firm as constituted under the partnership deed. According to the partnership deed (Exhibit B) the partners and their shares are as follows :—

Vir Bhan Rs. 0-2-9; Ram Gopal 0-2-3; Ram Sarup 0-4-0; Jai Ram Das 0-4-0; Shanti Sarup 0-3-0.

As the registration of the firm has been allowed the demand of super tax against the assessee in this case will disappear. The assessment order is, therefore, to be read subject to the foregoing modifications. In the assessment the assessee claimed a deduction of Rs. 5,053, on account of interest paid as follows :—

	Rs.	A.	P.
Messrs. Virbhan Omparkash	320	15	0
Shanti Sarup	2,622	6	6
Fatehchand Jairamdas	2,109	14	9

The Income Tax Officer disallowed the whole claim on the ground that it was interest paid to partners by way of appropriation of profits. The partnership deed, dated 27th January, 1934 contains a recital that interest will be paid at Rs. 0-7-9 per cent per mensem on whatever money is invested by the partners on interest. From the partnership deed it will also appear that Fateh Chand is the name of the father of Jairam Das.

2. In the assessment the assessee also claimed a deduction of Rs. 22,429 on account of profits paid to Messrs. Jagan Nath Syal and Co., Chichawatni, and the Income tax Officer disallowed the claim on the following grounds :

"The factory of Messrs. Gopal Shah Nathu Shah had been taken on lease by Messrs. Jagan Nath Syal and Co., Chichawatni, who are probably an unregistered firm. The latter firm entered into an agreement with Messrs. Gopinath Birbhan, with a view to carrying on the ginning and pressing work for them on the following conditions :—

(i) All raw cotton purchased by Messrs. Gopinath Birbhan say party No. 1, would be got ginned from Messrs. Jagan Nath Syal and Co., call it party No. 2. (ii) That party No. 2 would not do ginning and pressing work of any other customer. (iii) That the ginning charges would be as detailed below :—

No. of bales.	Charges.			
	Rs.	A.	P.	
If less than 2,000	5	12	0	per bale of
If more than 2,000 but less than 3,000	5	6	0	392 lbs.
If more than 3,000 but less than 4,000	5	2	0	per bale
If more than 4,000 but less than 4,800	5	0	0	"
If more than 4,800	4	14	0	"

"Besides the above stipulated rates of ginning, the party No. 1 would pay 1/3rd of the net income made in cotton and cotton seed business after deducting all business and other expenses and interest at 6 per cent per annum together with bad debts, etc. In case of loss nothing would be paid and the whole loss would be incurred by the party No. 1. The party No. 2 would have nothing to do with the losses. In that case it would simply receive ginning charges and nothing else. Agreement, dated 22nd March, 1935, is placed on the file. This agreement confirms the previous one made

orally—*vide* copy of the letter, dated 14th October, 1933, placed on the file.

This amount which is alleged to have been paid to Messrs. Jagan Nath Syal and Co., Chichawatni, out of the *net income* (i.e., after the net income was determined or it came in existence) cannot be regarded as an expenditure incurred solely for the purpose of earning that income, as required in Section 10 (2) (ix) of the Indian Income tax Act. Only those amounts can be allowed as deductions from the taxable income which were spent before earning the income, such as ginning and pressing charges amounting to Rs. 68,466 which were duly allowed. Any alleged expenditure incurred after the income came into existence is, therefore, obviously inadmissible. In this connection a reference is invited to the following rulings :—

(i) Madras High Court ruling in the case of *R. E. Mohamad Kasim Rowther and Co., Negapatam* (2 I.T.C. 482).

In the case under discussion too the payment was dependent on the amount of profits.

(ii) Bombay High Court ruling in the case of *Messrs. C. Macdonald & Co.*, (7 I.T.C. 466).

(iii) Privy Council ruling in the case of the *Pondicherry Railway Co. v. The Commissioner of Income tax, Madras* (5 I.T.C. 363): "profits on their coming into existence attract tax at that point and the revenue is not concerned with the subsequent application of the profits."

The case of *Raja Bejoy Singh Dudhuria v. The Commissioner of Income tax, Calcutta* (6 I.T.C. 449) quoted by learned Counsel is clearly distinguishable and does not apply to the case under review. In that case the lady's charge was not confined to the income of the estate but extended to the *corpus*. Charge had to be met irrespective of the fact whether there was any income from the estate or not. In the present case the payment was admittedly to be made if there *were profits*. In the absence of any income no payment was to be made at all.

In the light of the above facts and rulings the deduction of Rs.22,429-6-9, claimed by the assessee, is disallowed. This represents one-third share of profit (net after excluding all expenses and deductions which amounted to Rs. 67,288, according to the assessee)".

The partnership deed (Exhibit B) contains some terms of the sub-lease between Jagan Nath Syal and Co., and the assessee. These terms seem to have been modified to some extent by an agreement dated 23rd March, 1935 (and not 22nd March, 1935,

as noted by the Income Tax Officer) between the assessee-firm on the one hand and Messrs. Jagannath Syal and Co., on the other. The agreement is written in Urdu, and an English translation is annexed (Exhibit C). This written agreement confirmed one previously made orally—*vide* English translation of a letter, dated 14th October, 1933, written in Urdu—Exhibit D). It will appear that in all the three documents, *viz.*, the partnership deed (Exhibit B), the agreement dated 23rd March, 1935, (Exhibit C) and in the letter dated 14th October, 1933, (Exhibit D) it was agreed that besides paying Messrs. Jagan Nath Syal and Co., the ginning rates the assessee-firm would pay Messrs. Jagan Nath Syal and Co., one-third of the net profit made after deducting all expenses, and that in the case of loss it would be borne entirely by the assessee-firm. In all these three documents the one-third share of net profits payable has been described as ginning charges. The amount of Rs. 22,429 was paid to Messrs. Jagannath Syal and Co., over and above the ginning rates as one-third share of the net profits by virtue of the above stipulation.

3. The assessee appealed against the disallowance of the interest payment of Rs. 5,053 and of the payment of Rs. 22,429 to Messrs. Jagannath Syal & Co., copies of the grounds taken on appeal with regard to these two items and of the relevant portion of the appellate order are annexed (Exhibits E & F respectively). So far as the interest payments are concerned, the Assistant Commissioner found that Virbhan Omparkash was a separate firm which was not a partner in the assessee-firm and therefore allowed Rs. 320-15-0 paid to it. From the appellate order it appears that it was not contended before the Assistant Commissioner that Rs. 2,109-14-9 was not paid to the partner Jairam Das but to the alleged firm Fateh Chand Jairamdas. Shanti Sarup admittedly stands in this capacity as a partner in the assessee-firm. The Assistant Commissioner upheld the decision of the Income Tax Officer in regard to the interest paid to Shanti Sarup and Jairam Das on the ground that it was interest paid to partners and there was no evidence that they were genuine borrowings from the two partners. The Assistant Commissioner also disallowed the claim of Rs. 22,429 paid to Messrs. Jagannath Syal & Co., and it appears from the appellate order (Exhibit F) that the following entry was made in the *Suhr Bahi* (journal of adjustment entries). "*Lal Jagan Nath Syal Co., ke jama babat nafa ghasai kharkhana. Hissa 5-4, rupa 67,288-4-6.*" Credited to Jagan Nath Syal & Co. for share of profit, depreciation one-third share of Rs. 67,288-4-6).

4. The assessee then came up with an application under Section 66 (2) (copy, Exhibit G), but my predecessor by his order dated 29th May, 1936, (copy, Exhibit H) rejected the application. Thereupon the assessee filed an application under Section 66 (3) (copy Exhibit I) before the hon'ble High Court.

5. **Questions referred.**—As directed by Their Lordships in their order, dated 28th June, 1937 (copy Exhibit J) I refer the following two questions for their Lordships' decisions :—

(1) "Whether the sum of Rs. 22,429 paid by the assessee to Jagan Nath Syal & Co., under the agreement between the assessee and Jagan Nath Syal & Co., is a legitimate deduction under Section 10 (2) Clauses (i) and (ix) of the Income Tax Act, and

(2) Whether the assessee is entitled to deduct Rs. 2,109, and Rs. 2,622 paid to Fatechand Jairamdas and Shanti Sarup, respectively, as interest on capital alleged to have been borrowed from them by the assessee."

6. **Opinion of the Commissioner.**—So far as question (1) is concerned, I submit that the stipulation in the partnership deed (Exhibit B) and in the agreement (Exhibit C) and the entry in the *Suhr Bahi* referred to in the appellate order (Exhibit F) leave no room for doubt that the payment of Rs. 22,429 to Messrs. Jagannath Syal & Co., was an appropriation of profits after they had been earned, and, therefore, not an admissible expenditure under Section 10 (2) (ix). In the three documents, Exhibits B, C & D, the one-third share of net profits payable has no doubt been described as ginning charges, but I submit that merely this description will not convert it into a recurring expenditure incurred solely for the purpose of earning the profits or gains. The method of computation itself as described in three documents (Exhibits B, C & D) shows clearly that it is an appropriation of profits after they had been earned. Moreover, the amount payable has no relation whatsoever with the ginning of cotton done by Messrs. Jagannath Syal & Co. inasmuch as it may be small or great or nothing according as the profits of the assessee are small, great or nothing—which is a most unusual feature in the case of ginning charges. I would refer to the decision of the Privy Council in the *Indian Radio and Cable Communications Co., Ltd. v. Commissioner of Income Tax, Bombay Presidency and Aden* (V I.T.R. 270) which is the latest decision on the subject. The facts of that case are very much similar to the facts of the present case. I would also refer to the Privy Council decision in the *Pondicherry Railway Co., Ltd. v. Commissioner of Income Tax Madras* (V I.T.C. 363) and the Bombay High Court

decision in *Messrs. O. Macdonald & Co. v. Commissioner of Income Tax, Bombay* (VII I.T.C. 466). Section 10 (2) (i) is not applicable either because nowhere in the partnership deed (Exhibit B) or in the agreement (Exhibit C) or in the letter (Exhibit D) is it stated that any portion of the profits was to be paid as rent of the factory or business premises. Moreover, in the *Indian Radio & Cable Communications Co., Ltd.* (V I.T.R. 270 at page 278) it has been held that rent cannot be such a fluctuating figure.

7. Question (2):—As regards the payment of interest to the partners, I submit the assessee has put in no evidence at all on the point that the investment standing in the name of Fatehchand Jairamdas is not the investment of partner Jairam Das but of a firm named Fatehchand Jairamdas. I have already pointed out that the name of Jairam Das's father is Fateh Chand. The Assistant Commissioner gave the assessee relief so far as Vir Bhan Om Parkhash was concerned because the assessee was able to produce satisfactory evidence before the Assistant Commissioner about the separate identity of that creditor. No such evidence was produced before the Assistant Commissioner in respect of Fatehchand Jairamdas. Under such circumstances, I submit the assessee has failed to establish the separate identity of the creditor Fatehchand-Jairamdas. Shanti Sarup stands admittedly in the capacity of a partner. The partnership deed (Exhibit B) shows that interest is paid on partners' capital and there is no evidence to prove that these borrowings are genuine deposits and not capital for developing the business. Under such circumstances, I submit that interest on partners' capital is not allowable expenditure. I would refer to the decision of the Allahabad High Court in the matter of *Lalla Mal Hardeo Das Cotton Ginning Mills* (1 I.T.C. 266). As, however, the assessee has been taxed as a registered firm, the partners are not in the least affected if their interests are disallowed in the assessment of the firm, because under Section 48 (2) they will get the necessary refund in their personal assessments.

8. For reasons stated above, my respectful submission is that both the questions should be answered in the negative."

Kirpa Ram Bajaj for the Assessee.

S. M. Sikri, for *J. N. Aggarwal*, for the Commissioner.

JUDGMENT.

This is a case stated by the Commissioner of Income tax under sub-section (3) of Section 66 of the Income Tax Act. The two

questions that were formulated by this Court for the opinion of the Commissioner were couched in the following terms :—

(1) Whether the sum of Rs. 22,429 paid by the assessee to Jagan Nath Syal and Company, under the agreement between the assessee and Jagan Nath Syal and Company is a legitimate deduction under Section 10 (2), Clauses (i) and (ix) of the Income-tax Act; and (2) Whether the assessee is entitled to deduct Rs. 2,109 and Rs. 2,622 paid to Fatehchand Jairamdas and Shanti Sarup, respectively, as interest on capital alleged to have been borrowed from them by the assessee.

In the opinion of the Commissioner both questions should be answered in the negative and we have no hesitation in agreeing with him.

The sum involved in question No. 1 was paid by the assessee to Jagan Nath Syal and Company, hereinafter called the company, in the following circumstances :—

The company took on lease a cotton ginning factory and the assessee entered into an agreement with the company for the ginning of his cotton. It was stipulated between them that besides the ginning charges, which were fixed in the agreement, the company would be entitled to one-third of the net profits calculated "after deducting all ginning charges at the above mentioned rates and all other expenses connected with the sale and purchase of cotton and seed, insurance, interest at 6 per cent. per annum travelling, food of workers and employees, staff salaries etc., bad debts and irrecoverable items". In case of loss no sum was to be paid to the company nor was the company liable to any contribution on that account. In the accounting year the assessee paid to the company Rs. 68,000 odd towards ginning charges and in addition Rs. 22,429 were paid to it which represented one-third of the net profits earned by the assessee after making the necessary deductions specified in the agreement. It is the latter sum which the assessee claims to deduct from his total income and the Income-tax authorities have refused to allow him to do so on the ground that it was covered neither by Clause (i) nor Clause (ix) of sub-section (2) of Section 10 of the Income-tax Act. It is a well-settled principle that if any deduction is claimed, it is for the assessee to prove that that deduction is legally allowable to him. If he fails to do so, the amount so claimed is liable to be assessed. It is obvious that Clause (i) of sub-section (2) of Section 10 does not cover the amount and it is significant that throughout the proceedings before the Income-tax authorities prior to the issue of mandamus by this

Court the assessee never based his claim on that clause. Had the sum in dispute been rent, it could easily have been so expressed in the agreement entered into between the assessee and the company. This however was not done nor can a fluctuating item like this be treated as rent. The following observations of their Lordships of the Privy Council in *Indian Radio and Communications Co. v. Commissioner of Income Tax, Bombay* (5 I.T.R. 270) are pertinent in this respect:—

“Circumstances of greater importance are that the sum payable may be small or great or nothing—a most unusual feature in the case of rent—and that it is impossible to presume or infer that the half share of profits is being paid only as rent or as a similar payment, in consideration merely of the use of the plant”.

We hold, therefore, that the sum in dispute could not be deducted as rent paid for the premises in which the assessee carried on his business.

It now remains to be seen whether it is “expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains”. Here too, as remarked above we are inclined to agree with the Commissioner that the payment of the sum in dispute was an appropriation of profits after they had been earned and not an admissible expenditure incurred for the purpose of earning those profits. In the case reported as 5 I.T.R. 270 (*ubi supra*) their Lordships of the Privy Council had occasion to consider a somewhat similar matter and observed as follows:—

“The sum is in truth made payable as part of the consideration in respect of a number of different advantages which the appellants derive from the agreement and not all of them can be shown to be of a purely temporary character. The agreement as a whole is much more like one for a joint adventure for a term of years between the appellant company and the Communications company than one for a lease for that period ... Their Lordships recognise the difficulty which may often exist in deciding whether expenditure not in the nature of capital expenditure has been incurred solely for the purpose of making or earning ‘income, profits or gains’ and they agree that it may be impossible to formulate a test which will always suffice to discriminate between the expenditure which is and which is not allowable for the purpose of income-tax, but in the present case they have little hesitation in coming to the conclusion that the proposed deduction is not allowable”.

In that case the Communications Company and the Radio Company entered into an agreement to the effect that their businesses in India should be combined and conducted by the Radio Company for a certain number of years. The Communications Company agreed to deliver all the plant, machinery, fittings etc., of their business in India to the Radio Company to be used by the latter during the period of the agreement and the latter agreed to pay one-half of its net profits for each of its financial years to the Communications Company. It was this half share of the net profits which was claimed by the Radio Company as a permissible deduction.

In *Pondicherry Railway Co. v. Commissioner of Income Tax, Madras* (5 I.T.C. 363), again a case that went to the Privy Council, their Lordships held that in computing the assessable profits or gains of the assessee's business no allowance was deductible in respect of the half share of the net profits payable by the assessee to the French Colonial Government. Lord MACMILLAN, who delivered the judgment, observed as follows :

"It is claimed for the Company that when it makes over to the Colonial Government their half of the net profits it is making an expenditure incurred solely for the purpose of earning its own profits. The Court below has unanimously negatived this contention and in their Lordships' opinion has rightly done so. A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point and the revenue is not concerned with the subsequent application of the profits".

In two subsequent cases his Lordship threw further light on these observations and tried to explain as to what his real import was in using these words. In *Union Cold Storage Co. v. Adamson* (16 Tax Cases 293, at page 381), his Lordship remarked :—

"When therefore, in the passage referred to by the Attorney-General in the *Pondicherry case* I said that 'a payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits,' I was dealing with a case in which the obligation was, first of all, to ascertain the profits in a prescribed manner, after providing for all outlays incurred in earning them, and then to divide them".

In *Tata Hydro Electric Agencies Ltd. v. Commissioner of Income Tax, Bombay* (64 I.A. 215), his Lordship once more adverted to the *Pondicherry case* and observed as follows :—

"In the *Pondicherry case* the assessee were under obligation to make over a share of their profits to the French Government. Profits had first to be earned and ascertained before any sharing took place".

His Lordship further added :

"Their Lordships recognise, and the decided cases show, how difficult it is to discriminate between expenditure which is, and expenditure which is not, incurred solely for the purpose of earning profits or gains. In the present case their Lordships have reached the conclusion that the payments in question were not expenditure so incurred by the appellants. They were certainly not made in the process of earning their profits; they were not payments to creditors for goods supplied or services rendered to the appellants in their business; they did not arise out of any transactions in the conduct of their business. That they had to make those payments no doubt affected the ultimate yield in money to them from their business, but that is not the statutory criterion In short, the obligation to make those payments was undertaken by the appellants in consideration of their acquisition of the right and opportunity to earn profits, that is, of the right to conduct the business, and not for the purpose of producing profits in the conduct of the business".

In the present case also the assessee had the advantage of securing a monopoly of ginning his own cotton and this was a substantial advantage that he had gained. We are even prepared to go further and say that in the present case the company and the assessee had started a *quasi* partnership business in which the company had to receive certain definite sums as ginning charges and had in addition to receive certain profits after making certain deductions and not to be responsible for any losses. The profits were to be paid to the company after they were earned and as such they cannot in any way be treated as an expenditure which the assessee had to incur for earning them.

The second question can be disposed of on the short ground that it is a question of fact whether the advance made by a partner is a loan to the partnership or an increase in the capital of the firm, and when once the income tax authorities have held that it was by way of an increase in the capital of the firm and not a loan independent of the partnership capital, we have no authority to interfere.

We accordingly answer both questions in the negative. The assessee will be liable to pay the costs of this reference to the Commissioner.

Questions answered in the negative.

[IN THE NAGPUR HIGH COURT.]

COMMISSIONER OF INCOME TAX, C. P. & U. P.

v.

ACHRULAL

SIR GILBERT STONE, C. J., and VIVIAN BOSE, J.

March 22, 1938.

ACCOUNTING—METHOD OF ACCOUNTING REGULAR—UNDERVALUATION OF CLOSING STOCK—PROCEDURE—ASSESSMENT AT FLAT RATE—LEGALITY—DUTY OF INCOME TAX AUTHORITIES TO ASCERTAIN TRUE PROFITS—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 13, 23.

The assessee adopted in the year 1932-33 the mercantile system of accounting which he had used in the previous years, but on the ground that the closing stock was undervalued the income tax officer levied assessment at a flat rate. The Commissioner stated that the assessment was made under Section 23 (3) and not under the proviso to Section 13 :

Held, (i) *that as the assessee had adopted a regular method of accounting it was incumbent on the income tax authorities to determine whether the profits could be correctly deduced therefrom and if they considered that the undervaluation of the closing stock made it impossible to deduce the true profits, it was their duty to act not under Section 23 (3) but under the latter half of the proviso to Section 13 ;*

(ii) *that the application of a flat rate is not always proper when a truer state of income can be ascertained without much trouble and it was for the Income tax Officer to consider whether it would not be fairer and more proper to apply the rate obtaining at the relevant date for the best quality of gold to the quantity given in accounts rather than to resort arbitrarily to a flat rate.*

Cases referred to :

COMMISSIONER OF INCOME TAX, MADRAS v. AHMEDABAD NEW COTTON MILLS Co., LTD., [1930] (54 Bom. 213 ; 121 I.O. 543).

COMMISSIONER OF INCOME TAX, MADRAS v. CHENGALVARAYA CHETTY [1925] (48 Mad. 836).

COMMISSIONER OF INCOME TAX, BOMBAY v. SARANGPUR COTTON MANUFACTURING Co., LTD., [1937] (A.I.R. 1938 P.C. 1 ; 1938 I.T.B. 36).

Case stated by the Commissioner of Income-tax, C. P. and U. P. under Section 66 (3) of the Indian Income-tax Act (Judicial Case No. 57 of 1937).

STATEMENT OF CASE.

Case stated under Section 66 (3) of the Indian Income-tax Act XI of 1922 (hereinafter referred to in this statement as the Act) at the behest of the Hon'ble the High Court of Judicature at Nagpur, by the Commissioner of Income-tax, Central and United Provinces for the decision of the question of law set out below arising out of the appellate decision of the Assistant Commissioner of Income-tax, Jubbulpore, under Section 31 of the Act in respect of the assessment of Messrs. Achhrulal Munnalal of Gadarwara, a Hindu undivided family (hereinafter referred to as the assessee) for the year 1932-33 :—

“Whether regard being had to the regular method of accounting followed by the assessee in respect of transactions relating to gold and to silver, it was open to the Commissioner of Income-tax to assess under the proviso to Section 13 of the Income-tax Act”.

2. **Facts of the Case.**—The assessee carries on, *inter alia*, gold and silver business. The business consists of the sale of bullion and ready-made ornaments. In support of its return for the year in dispute (1932-33) the assessee produced accounts which, when examined revealed a profit of Rs. 1,914 on sales of gold bullion and ornaments aggregating to Rs. 3,72,127-13-0 which the Income tax Officer considered to be suspiciously low. On further analysis he found that the accounts were not cast in such a manner as to enable him to check the accuracy of the profits worked out in them. At the same time he found also that the profit on sales of silver though not susceptible of a similar check was reasonable, having regard apparently to what he found to be the case with other dealers in the same trade. He, therefore, accepted the profit in the silver account but not in the gold account. This he worked out at a flat rate of 3 per cent gross and added Rs. 9,249 to the net profit worked out by the assessee. It is this amount which is the bone of contention in this case. An extract copy of his assessment order is annexed as Appendix A. It will appear from it that in abbreviating his remarks he has assumed what happened in the preceding year, that is, in the year 1931-32. He found the accounts to be in the same condition as in that year. It would, therefore, not be irrelevant to give a brief history of the case here. Before the year 1930-31 the assessee allowed itself to be assessed on estimates

under Section 23 (4) in the absence of accounts. For the year 1930-31 it produced accounts which were not accepted as (1) owing to non-production of accounts in 1929-30 there was no check on what had been brought forward as the opening stock—a factor which always tends to reduce profits, and (2) the stock list did not describe (a) the ornaments in stock, (b) the quality of metal used and (3) wages for converting it into ornaments separately for each ornament. The assessee was unable even to state separately the sales of bullion and sales of ornaments. The Income-tax Officer therefore, assessed it at 3 per cent. on sales of gold. In the year 1931-32 the assessment was repeated on the percentage basis and on appeal the rate was reduced from 4 to 3 per cent. on sales of gold. The reasons were insufficiently of details to check the accuracy of the closing stock with and consequently that of the profit worked out. On appeal the rate was reduced to 3 per cent. as in the year before. In respect of the year in dispute, that is 1932-33, the assessee filed an appeal contending *inter alia*, that in the face of regularly and correctly maintained accounts the Income-tax Officer was not justified in applying a flat rate to the sale of gold because (1) the value of gold was determined in terms of silver; (2) there were enormous fluctuations in the price of gold; (3) the large increase in the turn-over was due to the exodus of large quantities of bullion at a low marginal profit and quick return often at a loss consequent on the fluctuation of prices. It is noteworthy that it was not alleged at any stage of the proceedings or in any year before that the assessee was using, as alleged on its behalf before your Lordships, domestic gold for the preparation of ornaments and that in consequence it was not possible for it to maintain a detailed account of the stock such as the Income-tax Officer expected. The Assistant Commissioner, after examining the accounts himself, agreed with the Income-tax Officer that the stock valuation was defective. On the one hand it was urged before him that the assessee used only pure gold in making ornaments while on the other it was urged that the gold ornaments in stock contained metal of different fineness and this discrepancy was sought to be explained by arguing that ready-made ornaments purchased from other dealers often contained inferior metal. The stock list gave no indication of stock purchased from outside and the stock of ornaments made by the assessee itself. He accordingly maintained the assessment on the percentage basis though he reduced the gross profit rate from 3 to 2 per cent. This he did because on a comparison of various transactions of sales accounted

for he found that that was the rate the assessee had earned. This rate was higher than the $\frac{1}{2}$ per cent. net profit rate to which the book profits, if accepted would have amounted. An extract copy of his order on appeal will be found in Appendix B. Dissatisfied with it the assessee applied under Section 66 (2), but the Commissioner of the time held that no question of law arose and therefore he declined to refer the case. An extract copy of his order declining the reference is in Appendix C. The assessee then moved your Lordships and obtained the order under Section 66 (3) requiring me to state a case on the question set out above. In the following year, that is to say, the year 1933-34, the assessee fully established the correctness of the stock and the Income-tax Officer accepted the profits as worked out in the books. It was proved by production of a statement showing the value of nearly all the ornaments in stock and the silver and gold accounts were accepted in their entirety.

Opinion of the Commissioner.—With all deference to the opinion of your Lordships, my submission is that the question as formulated is misconceived. In the first place the proviso to Section 13 of the Act has no reference "to the Commissioner of Income-tax". Secondly, no accounts were produced prior to the year 1931-32. —Assessments used to be made on estimates under Section 23 (4) and on the very first occasion when the accounts were produced in 1930-31 no material was made available to enable the Income-tax Officer to verify the correctness of the profit worked out. The stock list did not contain requisite details to check the closing stock with. The assessment in dispute is for the year 1932-33. In the circumstances it will not be strictly right to start with the assumption implied in the words of the question "regard being had to the regular method of accounting followed by the assessee". Thirdly, assuming that the assumption is well founded, may I ask in all humility whether the mere fact that accounts are maintained on a certain system for a series of years, is conclusive of their ability to reflect true profits? A wholly wrong method may deliberately be employed systematically over a number of years with an ulterior object and the accounts, though regular in one sense, may yet repel the application of the substantive part of Section 13 and invoke that of the proviso inasmuch as they fail to reflect true income, profits and gains, and whether this is or is not the case is not a proper question of law such as is cognizable by your Lordships but a question of fact which is primarily within the sole competence of the Income-tax Officer and

that of the Assistant Commissioner on appeal. Subject to appeal he is the sole arbiter for its decision. He has decided it adversely to the assessee and the Assistant Commissioner has upheld his decision. This question of fact has been finally decided and is, I respectfully submit, not approachable through the back door of Section 66 (3). I venture to point out also that what your Lordships have to consider is the question arising out of the order under Section 31, that is to say, the appellate order of the Assistant Commissioner and in this order he has made it plain that the question involved was not the question of the method of accounting but the question whether the valuation of the stock as given in the list was correct or not and the list did not show what the basis of the valuation was. That is in effect his finding. Whether this finding is true or not is not the point for the consideration of your Lordships. Your Lordships are entitled only to see whether there was any evidence on which such a finding could be based and if what I say is correct, then the question as framed must be modified so as to reflect whether there was evidence at all in the circumstances of this case to reject the gold account and calculate the profit on sales of gold and gold ornaments in the manner he has done. Fourthly, there is no reference to the application of the proviso to Section 13 of the Act either in the order of the Income tax officer or in that of the Assistant Commissioner, nor does the assessee rely on it in the two questions which it has submitted in its application under Section 66 (3) to your Lordships. I venture therefore to submit that the action of the Income tax officer does not purport to be and is, in fact, not an action under the proviso to Section 13 but is an action under Section 23 (3) of the Act. On receipt of the return of income the Income tax officer called upon the assessee under Section 23 (2) of the Act, to produce evidence in support of the return put in. The accounts that the assessee produced were found, on examination, not to give all the materials necessary for determining the profit in the gold account and, therefore, to the extent that the accounts were deficient, the Income tax officer had to estimate the profit from the sales of gold and gold ornaments in compliance with Section 23 (3) of the Act which required him to arrive at a true determination of the income after considering the evidence produced. Hence this was a case in which the Income tax officer was free to adopt the basis and manner of working out the profit in the gold account which he considered to be the most accurate for the purpose of making such a determination. The Assistant Commissioner has not only held

that the list of stock did not state the principle on which it had been made out but also, on an analysis of the accounts that the gross rate of profit worked out at 2 per cent. Profits depend to a degree on the correctness of the valuation of the opening and the closing stocks and this was inconsistent with the profits shown in the books. He did not, therefore, accept the book profit but having regard to the fact that the gross profit was lower, he applied the rate of 2 per cent. instead of 3 per cent. which was the rate applied in the year 1931-32. The average rate actually worked out to $2\frac{1}{2}$ per cent. In the case of the *Maharajadhiraj of Darbhanga v. Commissioner of Income tax, Bihar* (9 Pat. 240) it has held by their Lordships of the Patna High Court that the question whether or not the assessee's accounts disclosed his true income was one of fact. The Lahore case of the *Pioneer Sports Ltd., v. Commissioner of Income tax, Punjab*, decided on June 29, 1934 (2 I.T.R. 305) is, I respectfully submit, not on all fours with this case. There the sole reason given by the Income tax officer for the rejection of accounts was the low profits. Here in this case the lower profits were the reason for the further scrutiny of accounts which revealed that the closing stock had not been properly valued and there were no materials to evolve correct valuation. It was not a question of the impossibility on the assessee's part to supply the details required in the list of the stock and this is clear from the fact that the assessee in the year 1933-34 did supply them and when this happened the Income tax officer accepted its account for the gold and silver business. In my humble opinion there was evidence in this case for the Income tax officer to reject the gold account and calculate the profit in the manner he has done. Whatever, therefore the form in which the question is put, that is to say, whether it is put in the form in which it has been transmitted to me or in the form I have proposed above, it should be answered in the affirmative.

The relevant portion of the statement was sent to the assessee for observation and suggestions and its letter, dated 22nd May 1935 is annexed as Appendix D. I see no reason to alter the statement of the case ”.

D. N. Chaudhari, for the Commissioner.

A. V. Wazalwar, for the assessee.

JUDGMENT.

On 19-9-1934 Niyogi, Additional Judicial Commissioner, as he then was, directed the Commissioner of Income tax, to state a case and refer the following question under Section 66 (3) of the Income tax Act ;

"Whether regard being had to the regular method of accounting followed by the assessee in respect of transactions relating to gold and to silver, it was open to the Commissioner of Income tax to assess under the proviso to Section 13 of the Income Tax Act".

2. In our opinion, the only answer possible to this question in the form in which it is couched is 'yes'. Section 13 states that

"Income, profits and gains shall be computed for the purposes of Sections 10, 11 and 12 in accordance with the method of accounting regularly employed by the assessee".

The question as framed assumed that there was a regular method of accounting. If that is so, then clearly the assessment can and must be under this section. But that does not reflect the dispute between the parties nor indeed is the question discussed in the body of the order. If the considerations with which Niyogi, A.J.C., was dealing are correct, then the assessment must be taken to have been not under Section 13 but under the proviso to it and the question will then be not whether there was a regular mode of accounting but whether, in the opinion of the Income tax Officer, it was possible to deduce the income, profits and gains properly from the method of accounting actually employed, nor would that end the matter, for if, in the opinion of the Income tax Officer, that was not possible, then the further question would have arisen namely, whether his opinion was final.

3. The Income tax Commissioner has felt a like difficulty in stating a case and has asked us to reframe the question. We agree that it will be necessary to do so. The Madras High Court acted similarly in *Commissioner of Income-tax v. Chengalvaraya Uthetti* (I.L.R. 48 Mad. 886 at 839).

4. As regards the underlying assumption in the question proposed, namely that there is "regular mode of accounting" in this case, that again is not what Section 13 deals with. A mode of accounting might be perfectly regular in the sense that it follows one of standard methods and yet not be the one regularly employed by the assessee, and that is what we have to see under Section 13. See *Commissioner of Income tax v. Ahmedabad New Cotton Mills Co. Ltd.* (I.L.R. 54 Bom. 213 at 216) and *Commissioners of Income-tax v. Sarangpur Cotton Manufacturing Co. Ltd.* (A.I.R. 1938 P.C. 1). This is a matter which Niyogi, A.J.C., has not considered and as

the Commissioner of Income tax questions it, we must examine it now.

5. The Income tax Commissioner's statement discloses that the assessee produced no accounts before 1930-31 but produced accounts for the first time in that year. They were not accepted because there were certain defects in them, but it is clear from the description given that they were made up according to the mercantile system. Accounts were again produced in 1931-32 and, according to the Commissioner again there were not enough details to enable the authorities to check the accuracy of the closing stock. 1932-33 is the year in dispute. The only defect so far as the present reference is concerned is the undervaluation (according to the defendant) of the closing stock. The Commissioner's order dated 7-8-1933 describes the position in these words:—

“th whole question is whether or not the closing stock is properly valued and whether the income made by the business in gold is somehow or other absorbed in the undervaluation of the closing stock”.

One these facts it is clear that the assessee adopted in the year 1932-33 the method of accounting which he had used in the two previous years and that, in our opinion, is enough to attract the provisions of Section 13.

6. That being so, it was incumbent on the Income tax Officer next to determine whether the income, profits and gains for purposes of Section 13 could be properly deduced from these accounts. In our opinion if the closing stock was undervalued, as the Commissioner states it was, then that was not possible and so it became the duty of the Income tax officer to proceed under the latter half of the proviso to Section 13. The position is exactly the same as the one in *Commissioner of Income-tax, Bombay v. Sarangpur Cotton Manufacturing Co. Ltd.* But the Commissioner states that this was not what the Income tax Officer did. He says the assessment was made under Section 23 (3) and not under the proviso to Section 13. If that is so, then the Income tax Officer or the Assistant Commissioner on appeal have not proceeded according to law. They have not applied their minds to the only provision under which they had power to proceed and the Income tax Officer will now have to do so. See *Commissioner of Income Tax, Bombay v. Sarangpur Cotton Manufacturing Co. Ltd.* (A.I.R. 1938 P.C. 1 at 3).

7. Section 23 deals with matters of *assessment* and not with the “*computation*” of the income, profits and gains for the purposes

of Sections 10, 11 and 12". It deals with the "return" and not primarily with the accounts. Under Section 22 (1) the return has to be in a prescribed form and this form provides separately for the heads of assessable income detailed in Section 6. Three of them, namely business, professional earnings and other sources are covered by Sections 10, 11 and 12. If the return is "correct and complete" then the Income tax Officer has to "assess the total income of the assessee" and determine the sum payable by him "on the basis of such return". He is bound to do this and has no option to do anything else.

8. Since the Commissioner of Income tax is clear that the Income Tax Officer has not acted under the proviso to Section 13, it will now be for him to proceed to the proper discharge of his duty under that provision of law. It is in the circumstances unnecessary for us to decide whether we could have interfered if he had acted under the proviso and had still applied a flat rate, but we would draw attention to the remarks of their Lordships of the Privy Council in *Commissioner of Income Tax, Bombay v. Sarangpur Cotton Manufacturing Co. Ltd.* (A.I.R. 1938 P.C. 1 at 3).

"The judgment of the Income Tax Officer under the proviso must be properly exercised. It is misleading to describe this duty of the Income Tax Officer as a discretionary power".

We would also refer to the cases which state that the application of a flat rate is not always proper when a truer state of the income can be ascertained without much trouble. It will be for the Income Tax Officer to consider whether it would not be fairer and more proper to apply the rate obtaining at the relevant date for the best quality of gold to the quantity given in the accounts rather than to resort arbitrarily to a flat rate.

9. As regards the argument of the assessee that the Income Tax Officer having accepted the accounts in respect of the transactions in silver though they contained some defects, he was therefore bound to accept those relating to the gold as well, we need only say that, in our opinion, there is no such obligation.

10. The costs of this reference will be paid by the applicant, the Commissioner of Income tax.

Order accordingly.

[IN THE NAGPUR HIGH COURT].

VITHAL v. COMMISSIONER OF INCOME TAX, C.P. & UP.

POLLOCK, J.

March 17, 1938.

REFERENCE—QUESTION WHETHER THERE WAS SUFFICIENT CAUSE FOR NOT MAKING RETURN IS QUESTION OF FACT—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 27, 66 (3).

The question whether there was sufficient cause for not making a return within the meaning of Section 27 of the Indian Income Tax Act is a question of fact.

Case referred to:

COMMISSIONER OF INCOME TAX, C.P. & U.P. v. LAXMINARAIN BADRIDAS [1937] (5 I.T.R. 170; I.L.R. 1937 Nag. 191).

Miscellaneous Civil case No. 69-B of 1935.

JUDGMENT.

POLLOCK, J.—This is an application under Section 66 (3) of the Income tax Act. For the year 1933-34 the applicant submitted a return showing a loss of income during the year. The Income tax Officer refused to accept this and issued notices to the applicant under Section 22 (4) calling upon him to produce his accounts and under Section 23 (2) calling upon him to produce his evidence. The applicant failed to appear or produce his accounts or evidence. He was therefore assessed under Section 23 (4), and his application under Section 27 that that assessment should be cancelled and a fresh assessment made was rejected.

2. The only point argued in this court is whether there was in the words of Section 27 sufficient cause for the applicant's not making the return required and whether that point is a question of law. In this application under Section 27 the applicant gave two reasons for his failure to produce accounts, (1) that his ward or partner Godhaji had obstructed him, and (2) that he was ill. The only evidence that he offered of these was the evidence of three witnesses who deposed that he was ill at the time. The Income tax Officer declined to accept the plea of sickness as sufficient cause and rejected the application. In his appeal against that order the applicant contended that his account books had been locked up by the police. He had not given evidence of that in the application under Section 27, nor relied on it. On the evidence adduced before the Income tax Officer he was entitled to hold that

there was not sufficient cause for the applicant's failure to comply with the notices, and the question whether there was sufficient cause or not appears to me to be clearly a pure question of fact, as was held by the Privy Council in *Commissioner of Income Tax, United and Central Provinces v. Laxminarain Badridas Akola*, (I.L.R. 1937 Nag. 191).

The application is therefore rejected with costs, Counsel's fee Rs. 75.

Application dismissed.

[IN THE CALCUTTA HIGH COURT].

MAHALIRAM RAMJEEDAS, *In re*.

SIR HAROLD DERBYSHIRE, C. J., KHUNDKHAIR, J.
and MUKHERJEA, J.

February 24, 1938.

RE-ASSESSMENT—INCOME ESCAPING ASSESSMENT—VALIDITY OF PROCEEDINGS FOR RE-ASSESSMENT UNDER SECTION 34—DECISION THAT INCOME HAS ESCAPED, WHETHER CONDITION PRECEDENT TO INSTITUTION OF PROCEEDINGS—PROCEEDINGS STARTED WITH NOTICE STATING THAT INCOME TAX OFFICER 'HAS REASON TO BELIEVE' THAT INCOME HAS ESCAPED—VALIDITY—*Obiter Dicta* OF HIGH COURT—WHETHER BINDING ON COMMISSIONER—RES JUDICATA—ESTOPPEL—INDIAN INCOME TAX ACT (XI of 1922), Sections 34, 66 (1).

Statements contained in a judgment which are not necessary to the decision, which go beyond the occasion and lay down a rule that is unnecessary for the purpose in hand have no binding authority. Where an application for a writ of prohibition in respect of a proceeding against the applicants under Section 34 of the Income Tax Act was dismissed on the ground that the issue of such a writ was discretionary and that unless there was breach of a fundamental principle of justice such a writ ought not to issue and also because the assessee had other remedies, but the learned judge said in the judgment that an Income Tax Officer has no jurisdiction to proceed under Section 34 unless he finds beforehand that income had escaped assessment: Held, that the opinion expressed by the learned Judge on Section 34 did not operate as res judicata, nor was it binding on the income-tax authorities,

The Commissioner of Income Tax has a statutory right to make a reference under Section 66 (1) and he cannot be estopped from exercising that statutory right.

As a general rule when once the Income-tax Officer has made an assessment under Section 23 (1) that assessment is settled and on the general principles of law governing estoppels, neither the subject nor the Crown ought to be at liberty to go behind the amount of profits and gains when once determined by any competent authority.

Where once an assessment has been made under the Income-tax Act, it is a condition precedent to the Income-tax Officer acting under Section 34 and proceeding to serve notices under Section 22 (2), that income, profits and gains chargeable to income tax has escaped assessment. The Income tax Officer being the person charged under the Act with the duty of taking action under Section 34 where such action ought to be taken, it is for him to decide whether income, profits or gains have escaped assessment.

In deciding whether income has escaped assessment he must not act on suspicion or conjecture. He must decide the question upon a fair and reasonable consideration of such information and materials as are available to him. He need not hold a formal enquiry but should give the assessee an opportunity of being heard before he decides against him that income has escaped assessment and proceeds to upset the settled account and he can proceed under Section 34 only if he decides on a consideration of all the materials before him that income has escaped. He cannot proceed to act under Section 34 merely because he has 'reason to believe' that income has escaped assessment.

Cases referred to :

COMMISSIONERS OF INLAND REVENUE v. BROOKS [1915] (1915 A. C. 478).

HARMUKHRAI DUNICHAND, *In re* [1928] (56 Cal. 39; 3 I.T.C. 198).

RAMJIDAS MAHALIRAM, *In re* [1936] (4 I.T.R. 25; I.L.R. 62 Cal. 1011).

REX v. SBAYER [1916] (1 K. B. 210).

Case stated by the Commissioner of Income tax, Bengal, under Section 66 (1) of the Indian Income Tax Act (XI of 1922), in the matter of the additional assessment of the firm of Mahaliram Ramjeedas for the year 1932-33.

The facts of the case are stated in detail in the Commissioner's statement of case which runs as follows :—

STATEMENT OF CASE.

I have the honour to draw up, on my own motion, a statement of case under Section 66 (1) of the Indian Income Tax Act (XI of 1922), hereinafter referred to as the Act, in connection with assessment proceedings for the year 1932-33 under Section 34 of the Act and in respect of the income of the year of account 1937-38 Dewali corresponding roughly to October 1930 to October 1931, involving a question of law arising out of the said assessment proceedings, as set out in paragraph 6 hereunder, to refer the same to the Hon'ble High Court, Calcutta, for its opinion thereon.

2. **Facts of the Case.**—The assessee Messrs. Mahaliram Ramjeedas is a registered firm made up of the following partners, all belonging to the same family (1) Sir Onkermal Jatia, (2) Kanai Lal Jatia, (3) Champa Lal Jatia and (4) Bisseswar Lal Jatia. On 26th May 1932 a notice was issued under Section 22 (2) of the Act calling for a return of income from the assessee for the year 1932-33, the return being due by 25th July 1932. The assessee applied for and was granted extension of time on several occasions on the ground that its account book had not been completed and finally adjusted but still failed to file a return, and a notice under Section 22 (4) calling for accounts was accordingly issued on 30th November 1932 and on 23rd December 1932, the accounts were produced and a return was filed simultaneously. A copy of this return is appended hereto (marked A). This return showed a loss of Rs. 8,54,385 under the head 'business' and no taxable income under any other head. The loss was explained by assessee's representative as due to a heavy fall in the price of hessians and in the share market generally and the loss as shown was accepted after certain minor adjustments and a net loss of Rs. 8,52,424 was computed and the assessee was assessed at nil. A copy of this assessment order is appended hereto (marked B). It is important to note that though the notice issued on 30th November 1932 in connection with these assessment proceedings called for complete sets of accounts for the year 1937-38, the assessee produced only his *Rokar*, *Nakal* and *Khata* but no other books or materials. Believing that the books so produced before him were the only books relevant as comprising the assessee's entire accounts for the year in question, and never suspecting that any relevant books etc., were withheld or any material information regarding the said assessment was suppressed, the Income Tax Officer proceeded with and completed the said assessment the same day, i.e., on the 23rd

December 1932 on the basis of the said books of accounts alone, without even calling for the assessee's bank pass books, the reason for such consideration shown to the assessee probably being the very high standing of the firm and its partners both in social and business circles. In the year prior to this (1931-32) also there was no detailed scrutiny of accounts and the loss shown by the assessee and accepted by the department was Rs. 22,30,558 and again in 1930-31 accounts were not called for at all and assessment was made on the basis of an abstract of the profit and loss account supplied by the assessee, the loss shown and accepted being Rs. 7,01,000.

3. At the beginning of January 1934 the Income Tax Officer received information from a certain source that the account books of the assessee hitherto produced before the department had always been manipulated, that a comparison of the cash book with the bank pass books within recent years, including the year of account in question, would show that they did not agree, and that large sums of money amounting to several lakhs which had been shown as received by the assessee in his bank pass books did not find entry in this cash book, and specific instances of some such discrepancies and inaccuracies were also supplied. This naturally gave the Income Tax Officer food for thought and after receipt of the information and before issuing notice under Section 34 of the Act on 8th February 1934 he made such enquiries as were possible regarding the truth or otherwise of these allegations. It is conceded that these enquiries and investigations, *ex hypothesi* were informal and *ex parte* and as a result of his enquiries the Income Tax Officer was satisfied (1) that the allegations regarding the discrepancies alluded to above between the assessee's books of account produced at the assessment and some of the entries in his Pass Books with the Mercantile Bank of India Limited, the Imperial Bank of India, the Central Bank of India and the Punjab National Bank were not without foundation, (2) that the assessee had withheld and/or suppressed facts and informations relevant and material to the assessment and thereby deliberately misled the Income Tax Officer in the matter of his arriving at a correct estimate of the assessee's income in the year of account and (3) that a *prima facie* case regarding some income, profits or gains chargeable to income-tax having escaped from that assessment was made out against the assessee. Accordingly on the 5th February 1934 the Income Tax Officer made an order directing notice to issue under Section 22 (2) read along with Section 34 and a notice in the

usual form was issued to the assessee on the 8th February 1934, a copy of which notice I reproduce immediately below:—

“ To the Proprietors,

Mahaliram Ramjidas (firm)

21, Rup Chand Roy Street, Calcutta.

Whereas I have reason to believe that your income from business and other sources which should have been assessed in the financial year ending the 31st March 1933 has wholly escaped assessment, and I therefore propose to assess the said income that has escaped assessment, I hereby require you to deliver to me, not later than the 9th March 1934 or within 30 days of the receipt of this notice, a return in the attached form of your income from all sources which was assessable in the said year ending the 31st March 1933”

calling for a fresh return of income. (It is to be noted that the expression ‘business and other sources’ in that notice should not be taken as meaning the same as all sources and that it really means ‘business’ the income of which taxable under Section 10 and ‘other sources’ the income of which is taxable under Section 12 of the Act. These words again refer back to the heads of income as set out in Section 6 of the Act).

4. The date for compliance with this return was 9th March 1934 and on 22nd March 1934 the assessee filed a fresh return showing exactly the same loss as in the earlier proceedings under Section 22 (2) proper. The Income-tax Officer then issued on 21st May 1934 notices under Sections 22 (4) and 23 (2) calling for accounts of the years 1934-35, 1935-36 and 1937-38 and for other evidence on which the assessee might rely in support of his return the date fixed being 28th May 1934. On that date, there was a partial compliance but the important books, viz., the ledgers and journals of the years of account 1934-35 and 1935-36 to which the Income-tax Officer attached great importance were not produced. On 28th June 1934, another notice under Section 22 (4) was issued calling for the bank pass books of 1934-35 to 1938-39 Dewali. (I may perhaps note at this stage that when this matter came before the Hon'ble Mr. Justice McNair in the High Court later in an application for a Writ of Prohibition staying these proceedings the learned Judge remarked in his order that this notice was irregular, as the Income-tax Officer could not call for the accounts of more than 3 years. With all respect, I venture to submit that this observation is not merited. What Section 22 (4) says is that the

Income-tax Officer can call for such accounts or documents as he may require, provided that he shall not require the production of any document relating to a period more than 3 years prior to the previous year. The year of account in this case was 1987-88 Dewali and to call for the bank pass books of the years 1984-85 onwards, is in my respectful submission therefore, not contrary to the provisions of Section 22 (4) of the Act. After two adjournments, the bank pass books only of Llyods Bank and that only for the period 1987-88 and 1988-89 were produced and no pass books of other banks were put in and on 17th August 1934, the assessee appeared through Counsel before the Income-tax Officer and put in a letter protesting against the illegality of the notice under Section 34 and the proceedings thereunder. This objection was rejected by the Income-tax Officer. The assessee then filed an application before the Commissioner on 15th September 1934 asking that he should set all the Income-tax Officer's orders aside or in the alternative that he should state a case under Section 66 of the Act and on that application the Commissioner passed the following order :—

“I have considered the application of the assessee dated the 15th September 1934. I am not prepared to interfere or to take any action under Section 33 or 66 of the Act at this stage when the assessment is still before the Income-tax Officer. The assessee may be informed accordingly”.

This order is dated the 3rd November 1934. The proceedings were then held in abeyance for some time to enable the Income tax Officer to secure copies of assessee's accounts direct from the Mercantile Bank of India under Section 37 of the Income-tax Act as the assessee had refused to produce the relevant pass books on the ground that they had been mislaid. On the 10th January 1935 notice of a mention in the High Court was served on the Commissioner and the Income-tax Officer by the assessee's Solicitors. A copy of this notice as well as the connected petition of the assessee is hereto appended (marked C and D). In the petition filed before the High Court the assessee prayed for (1) an order for the issue of a writ of certiorari on the Commissioner of Income Tax to bring up the records of the assessment proceeding pending before the Income tax Officer, to the end that the order of the Income tax Officer passed on the 5th February 1934 under Section 34 of the Act and all proceedings consequent upon such order be quashed, including an order of the Income tax Commissioner, dated the 3rd November 1934 and purporting to dispose of the

assessee's application under Section 33 of the Act, dated the 15th September 1934, in the alternative for an order directing the Commissioner of Income tax to hear and determine the assessee's application under Section 33 of the Act and or to state a case according to law ; (2) an injunction pending disposal of the motion restraining the Income-tax authorities from proceeding further with the matter and (3) an ad interim injunction in similar terms. The application was heard by the Hon'ble Mr. Justice MCNAIR and His Lordship, by his order, dated the 6th March 1935, was pleased to dismiss the application and declined to issue any of the writs as prayed for by the assessee, holding, *inter alia*, that :—

“ It is evident that the legislature intended the Commissioner to deal with questions that come to his notice under Section 33 and if he passed an order which the assessee considers prejudicial they provided a method by which the legality of the proceedings could be tested. It was obviously their intention that provisions of Section 66 relating to a reference should be strictly complied with, and, if there was no such compliance, they intended the Commissioner's orders to be final and the jurisdiction of the High Court to be excluded ”.

The guiding principle appears to be that the writ in such a case will not issue unless the want of jurisdiction complained of is based upon a breach of a fundamental principle of justice. Here the orders complained of do not in my opinion come within the exception and I am not satisfied that this is a case in which a writ of prohibition should issue ”.

At the same time His Lordship examined in considerable detail the question whether these proceedings initiated under Section 34 of the Act were in accordance with a correct construction of that section and though His Lordship's finding must in my respectful submission in the circumstances, be held to be in the nature of obiter dictum, His Lordship definitely found that they were not, and held that these proceedings were without jurisdiction. The assessee though he failed in the main issue, that is, the issue placed before the Court in the application, did not file any appeal nor came forward with any application under Section 66 (2) against the Commissioner's order, dated the 3rd November 1934, as to which there was a clear indication given to the assessee by His Lordship as quoted above. And the question then arose as to what the revenue authorities should do in view of the Hon'ble Judge's remarks that the proceedings were irregular and without jurisdiction. The Commissioner after considering the matter addressed

to the assessee a letter, dated the 15th August 1935 stating *inter alia*, that after giving the most respectful consideration to every part of His Lordship's judgment he still felt inclined to the view that any interference at this stage would be premature and that accordingly he would not interfere now. The case was then resumed by the Income-tax Officer on 2nd September 1935 when a part of the accounts was examined, but on that date it was brought to the Income-tax Officer's notice that a petition had been filed before the Commissioner under Section 33 of the Act against his decision to proceed with the enquiry. The Commissioner did not treat this petition as one under that section and informed the assessee in his letter, dated the 16th September 1935 that no case was made out for any interference on his part at this stage. The assessee then moved the High Court again and in this connection served on the Commissioner and on the Income-tax Officer a notice, dated the 26th September 1935 intimating that the Hon'ble Court would on the 18th day of November 1935 or as soon thereafter as Counsel could be heard, be moved for—

(1) A Rule, absolute or nisi for—

(a) A Writ of Prohibition prohibiting the Income-tax Officer of Calcutta District No. IV (3) from proceeding further to re-open the petitioning firm's assessment for the Sambat year 1987-88 or otherwise continuing or purporting to continue the proceedings initiated by the order of the 5th February 1934 or pursuant to the notice of the 8th February 1934 in that regard.

In the alternative, for a Rule absolute or nisi for—

A Writ of Certiorari addressed to the Commissioner of Income-tax, Bengal, directing him to bring up the record of the assessment proceedings pending before the Income-tax Officer of Calcutta District No. IV (3) wherein the registered partnership firm of Mahaliram Ramjeedas of 21, Rupchand Roy Street, Calcutta, are the assesseees in respect of the financial year 1932-33 to the end that an order of the said Income-tax Officer passed in the said proceedings on the 5th February 1934 purporting to be under Section 34 of the Indian Income-tax Act (XI of 1922) be quashed, and the notice, dated the 8th February 1934, be set aside and all proceedings consequent upon the said order and the said notice be quashed or such further or other orders be passed as to this Hon'ble Court may seem just.

In the further alternative, for an order directed to the Commissioner of Income tax, Bengal and or the said Income tax Officer directing the said persons and each of them to forbear proceeding

further with proceedings initiated by the respective Order and Notice of the 5th and 8th February 1934.

(2) If necessary, an injunction pending the disposal of any Rule nisi issued herein, restraining the Income-tax Officer of the Calcutta, District No. IV and (or) the Commissioner of Income-tax, Bengal from further proceeding under the order of 5th of February 1934 or any other purporting to be one under Section 34 of the said Act and having reference to the petitioners firms' said income from business or other sources which should have been assessed in the financial year ending on the 31st March 1933.

(3) If necessary, an ad interim injunction in similar terms.

(4) An order that the said Income-tax Officer and (or) the Commissioner of Income tax, Bengal, do pay to the petitioners their costs of and incidental to this application.

5. When this application came before the High Court for hearing on the 14th January 1936 before the Hon'ble Mr. Justice Panckridge it was withdrawn by the assessee upon Counsel for the Income-tax authorities undertaking to state a case under Section 66 (1) of the Act and to stay proceedings under Section 34 in the meantime. A copy of the judgment of the Hon'ble Mr. Justice McNair, dated the 6th March 1935, is appended hereto (marked E) and I quote below relevant extracts from that judgment for facility of reference by the Hon'ble Judges hearing this present matter :—

“ Section 34 provides :—

‘ If for any reason income, profits or gains chargeable to income tax has escaped assessment in any year or has been assessed at too low a rate the Income-tax Officer may at any time within one year of the end of that year serve on the person liable to pay tax on such income, profits or gains.....a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of Section 22 and may proceed to assess or reassess such income, profits or gains and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were issued under that sub-section.’ The section provides for a reopening of the assessment and empowers the Income tax authorities to call for books and evidence, but before these powers may be exercised, and the assessment that has been closed may be reopened, the essential pre-requisite is that something chargeable to income tax has escaped assessment. The notice under Section 34 it will be observed merely states that the Income tax authority “ has reason to believe ” that income has escaped assessment. That Mr. Barwell

contends is not sufficient. The Act in many instances notably in Sections 22 (2), 23 (1) and (2), 23A, 24A, 25A, and elsewhere uses expressions such as "If in the Income-tax Officer's opinion", if the Income tax Officer "is satisfied", or "has reason to believe", or "may in his discretion direct", which gives the Income tax Officer a discretion and power to use that discretion."

"In Section 34 no such discretion is allowed. What is contemplated is that some item liable to tax has in fact escaped taxation, and only when that fact is in existence may the Income tax authorities use their powers to reopen an assessment which has already been closed and which under the scheme of the Act is otherwise intended under Section 23 to be closed finally".

"It is the general policy of the law that when accounts have been gone into and a balance has been struck and agreed upon, such an agreement should not lightly be set aside. It is not unlikely that the Legislature had this principle in mind and were unwilling to have an assessment reopened merely at the discretion of the Income-tax authority in view of the inevitable dislocation to the assessee's accounts and business".

"In any event Section 34 has been so worded that it does not leave the matter in the discretion of the Income tax Officer but provides that the machinery in Section 22 may be set in motion a second time only if an item chargeable to income tax has escaped assessment, and the ordinary meaning of those words is that the escape from assessment is a fact."

* * * * *

"But apart from the fact whether the notice was correct in form, the principle which the above cases lay down is that the words of the Act do not empower the Income tax Officer to reopen an assessment merely to enquire further into the assessee's books in case something assessable may be found; and if I am right in my view that it is an essential prerequisite to reopening an assessment that an item of income, profits or gains has escaped assessment the Income-tax Officer cannot give himself jurisdiction by an erroneous finding of fact.

If the Income-tax Officer is entitled to reopen an assessment merely on suspicion no doubt he is justified in maintaining silence, but in my view no such intention of the Legislature appears in the words of the section."

* * * * *

(The learned Judge appears to have obtained the impression that the Income-tax Officer in this case reopened the assessment on

mere suspicion and merely for the purpose of enabling him to conduct some sort of roving enquiry, but that this is not the correct position is, I respectfully submit, apparent from what I have said in paragraph 3 above.)

"The real question in my opinion is whether the section is so worded as to grant the Income tax Officer apart from his territorial jurisdiction the power to determine conclusively the question of fact upon which his jurisdiction depends".

"The Legislature in my view has provided that if a certain state of facts exists and is shown to the Income-tax Officer to exist before he proceeds to reopen the assessment under Section 34 he shall have jurisdiction to take proceedings, but not otherwise".

"It is not for him to decide whether that state of facts exists and if he reopens the assessment without its existence he is acting without jurisdiction."

"I find no words in Section 34 which empower the Income-tax Officer to determine whether the preliminary state of facts exists."

6. **Question referred :** The question arising out of this matter which I respectfully submit for the decision of Their Lordships under Section 66 (1) of the Act may be formulated as follows :

"Where the Income tax Officer has, on such materials and information as are available to him, reason to believe that income from any of the heads of income described under Section 6 of the Indian Income tax Act—in the present instance, from 'business' and 'other sources'—which should have been assessed in the year of assessment has escaped assessment, and, as a result of such enquiries and investigations as are possible at that stage, has been satisfied as stated in paragraph 3 of the statement that a *prima facie* case has been made out against the assessee for assessment under Section 34 of the Act, whether, on a true construction of Section 34 of the Act, it is not open for the Income tax Officer to initiate proceedings under Section 34, affording at the same time ample opportunities to the assessee to produce such evidence to the contrary as he likes, in the course of the proceedings thus initiated, or, on the other hand does the Section contemplate that the factum of such escapement should have been first proved and definitely found and determined by an independent enquiry, before the Income tax Officer can assume jurisdiction to reopen the assessment under Section 34?"

7. **Opinion of the Commissioner.**—I respectfully give my opinion below on that question.

Section 34 of the Indian Income tax Act says that if for any reason, income, profits or gains chargeable to income tax has escaped assessment in any year.....etc. In my respectful submission it would not be correct to read this to mean that before any action under Section 34 can be taken, the Income tax Officer must be in a position to find that income has as a matter of fact, escaped assessment, and that before taking any action under this section, he must definitely find whether any, and if so what, income has escaped assessment and when he has found that, and then only can he take action under the Section for the purpose of assessing the income which he has found to have escaped assessment. I would respectfully submit, that this reading of the section renders it practically unworkable and in my respectful opinion that section does not bear this narrow meaning. The section does not say "If the Income tax Officer finds that for any reason profits or gains chargeable to income tax has escaped assessment.....etc". What the section requires is that "income, profits or gains.....etc has escaped assessment" and not that it has already been found by any authority to have so escaped. It may be right to say that what is contemplated is that some item liable to tax has, in fact, escaped taxation and only when that fact is in existence may the Income tax authorities use their powers to reopen the original assessment, but it does not follow that before starting a proceeding under Section 34 all these facts must be definitely found. These facts may be in existence and yet the Income tax Officer may not be in a position to pronounce his final decision regarding their existence up to a certain stage and if the other view is correct, the Income tax Officer should hold an *ex parte* enquiry to find whether or not the requisite facts are in existence and for the purpose of this enquiry he could not call upon the assessee to take part in the investigation and the decision arrived at as the result of that investigation could not be conclusive. The Income tax Officer may word the preamble of his notice by saying "Whereas I find that such and such income has escaped assessment....." but this statement is of no value if it is not to be final and binding on the assessee and it cannot be so binding and the assessee will be entitled to a fresh enquiry to be held in his presence and it is only the result of this latter enquiry which will ultimately determine whether or not income really escaped assessment. In this case, the Income tax Officer must have been satisfied on information received that income had escaped assessment. It is not necessary under this section for the Income tax Officer to disclose his evidence or source

of information and the expression "I have reason to believe" does not mean that the Income tax Officer was not in a position to find that the income had escaped assessment. His information might have been otherwise definite and decisive, but before hearing the assessee and without waiting to see what further materials the assessee might place before him, it was possible for him to say that income had escaped assessment and when he says "I have reason to believe" in his notice under Section 34, what he means is "so far as I have been able to determine hitherto I find that income under the specified heads has escaped assessment but this finding is subject to whatever explanation or evidence you may offer to the contrary".

8. I may perhaps at this stage refer to the analogous provision in the English statute. Section 125 of that statute provides that if the surveyor discovers that any properties or profits chargeable to tax have been omitted from the first assessment he may take steps for their assessment and in *Rex v. Commissioners of Taxes* (7 T.C. 59) the United Kingdom Court has held that 'discovery' means "honestly comes to the conclusion on the information in his possession that a person is chargeable and has not made a full and proper return of his profits for assessment". In another case *King v. The Kensington Income Tax Commissioners* (6 T.C. 279) the word 'discovery' has been interpreted as meaning "come to the conclusion from the examination he makes and from any information he may choose to receive" and in the same case another Judge interpreted the word as meaning "has reason to believe". While another Judge took the word as equivalent to "finds or satisfies himself" and the word was taken as not meaning "ascertained by legal evidence". This view was not dissented in the case of *The King v. The Kensington Income-tax Commissioners* (6 T.C. 613 (618) while in the case of *Rex v. Commissioners of Taxes* (7 T.C. 59) referred to above the word was taken as meaning "honestly comes to the conclusion from information before him". While in a very recent case *Williams v. W. W. Grundy* (18 T.C. 271; 1934, 1 K.B. 924) it was held that a change of mind by the Inspector of Taxes amounted to discovery by him that an item chargeable to income-tax had been omitted within the meaning of Section 125.

9. In my respectful opinion, Section 33 does not in this respect materially differ from the provisions in the English statute and while this section no doubt contemplates that the Income-tax Officer must take some steps to satisfy himself as to the factum of

escapement, when he has done that he is to proceed exactly in the way in which the Income-tax Officer in the present case proceeded when he issued a notice saying "whereas I have reason to believe that your income from business and other sources which should have been assessed in the financial year....." and the proposal was to assess the said income that had escaped assessment.

10. The correct construction of Section 34 has frequently been before the High Courts in India but not quite in the form in which the question has arisen in this case. I would, however, invite Their Lordships' attention to the view expressed by the Calcutta High Court in the case of *Anglo Persian Oil Company v. Commissioner of Income-tax, Bengal* (6 I.T.C. 419; 60 Cal. 843; 37 C.W.N. 480) where it was held that Section 34 is not limited to cases of non-disclosure by an assessee or discovery of new matter by the income tax authorities or inadvertence as distinguished from erroneous deliberations on their part and a deduction improperly allowed in an assessment is a case of part of income escaping assessment within the meaning of that section and this view of the section as taken by the Calcutta High Court was referred to with approval by the Bombay High Court in the case of *Gopal Vajjnath Manohar v. Commissioner of Income-tax, Bombay* (8 I.T.C. 273 (278). Again the Lahore High Court in the case of *Amir Singh Sher Singh v. Commissioner of Income-tax, Punjab* (8 I. T. C. 198; A. I. R. (1935) Lah. 361; 3 I. T. R. 171) held that the words "escaped assessment" in Section 34 of the Income tax Act include all cases of mere inadvertence or conscious misapprehension of the proper situation or error of judgment and that this section empowers an Income-tax Officer to revise the assessment already made and to assess a sum which had not been assessed by his predecessor on account of the wrong application of the Act. In the case of *Madan Mohan Lal v. Commissioner of Income-tax, Punjab* (8 I.T.C. 413) a Full Bench of the Lahore High Court held that Section 34 of the Act is not confined to cases where income had not been returned at all. It applies also to cases where an item of income is included in the return made by the assessee but is left unassessed by the Income-tax Officer or if assessed in the first instance, the assessment is cancelled by any appellate or revisional authority. The rulings of the Indian Courts referred to above have perhaps no direct bearing on the question at issue, but I would respectfully submit that they do conclusively show that the whole tendency of the Courts in India is to put a very wide construction on the words of this section, while if the

obiter dicta of the learned Judge of the Calcutta High Court, which are the occasion for this statement of case, are correct it follows that a very narrow construction should be placed on the wording of the section and in fact, the section becomes unworkable and if income must, as a fact have escaped assessment and the Income tax Officer must find as a fact that income has so escaped then there is no apparent reason why the Income-tax Officer should not proceed immediately to assessment of this income without issuing a notice on the assessee at all and without waiting to hear and consider what explanation the assessee may have to give."

Supplementary Statement of Case

As directed by the Hon'ble High Court in their Lordships' order dated the 11th August 1936, the Commissioner referred the following further question of law and made the following statement of the case for the purpose :—

"Whether the Income-tax Officer is precluded from proceeding with the reassessment by reason of the Judgment delivered by the Honourable MR. JUSTICE MCNAIR on the sixth day of March one thousand nine hundred and thirty-five?"

2. The facts about the assessment under controversy have been stated in detail in the statement of the case which was drawn up by my predecessor. With reference to paragraph 3, page 2 of the Paper Book I would state that the assessee had banking account with three banks, viz., Mercantile Bank of India Limited, Central Bank of India Limited and the Punjab National Bank, and not with four banks. So far as the question of law referred to above is concerned the relevant facts will be found in paragraphs 4 and 5 of the statement of the case submitted by my predecessor at pages 2 to 7 of the original Paper Book. In his petition filed before the Hon'ble High Court notice of which was served on the Commissioner on the 10th January, 1935, the assessee prayed for—

(1) An order for the issue of a writ of certiorari on the Commissioner of Income-tax to bring up the records of the assessment proceeding pending before the Income-tax Officer, to the end that the order of the Income-tax Officer passed on the 5th February 1934, under Section 34 of the Act and all proceedings consequent upon such order be quashed, including an order of the Income-tax Commissioner, dated the 3rd November, 1934, and purporting to dispose of the assessee's application under Section 33 of the Act, dated the 15th September, 1934, in the alternative for an order directing the Commissioner of Income-tax to hear and determine

the assessee's application under Section 33 of the Act and (or) to state a case according to law ; (2) An injunction pending disposal of the motion restraining the Income tax authorities from proceeding further with the matter and (3) An ad interim injunction in similar terms.

The application on being heard by the Hon'ble MR. JUSTICE McNAIR, His Lordship by his order, dated the 6th March, 1935, was pleased to dismiss the application and declined to issue any of the writs prayed for by the assessee and held *inter alia* the following :—

“ It is evident that the legislature intended the Commissioner to deal with questions that come to his notice under Section 33 and if he passed an order which the assessee considered prejudicial they provided a method by which the legality of the proceedings could be tested. It was obviously their intention that provisions of Section 66 relating to a reference should be strictly complied with, and, if there was no such compliance, they intended the Commissioner's orders to be final and the jurisdiction of the High Court to be excluded.”

“ The guiding principle appears to be that the writ in such a case will not issue unless the want of jurisdiction complained of is based upon a breach of a fundamental principle of justice. Here the orders complained of do not in my opinion come within the exception and I am not satisfied that this is a case in which a writ of prohibition should issue.”

His Lordship however made some observations in the course of the judgment to the effect that the proceedings under Section 34 were without jurisdiction. The relevant extracts from the judgment are quoted in pages 6 and 7 of the original Paper Book. The assessee although he did not succeed in his prayer before the Hon'ble High Court did not file any appeal against the decision of the Hon'ble MR. JUSTICE McNAIR nor did he come forward with an application under Section 66 (2) of the Income tax Act against the Commissioner's order, dated the 3rd November, 1934, about which there was clear indication given to the assessee by His Lordship. The proceedings before the Income tax Officer are under the provisions of the Income tax Act, Section 66 of the Act provides under what circumstances order of the High Court should be invoked and in what manner it should be carried out. The provisions are quoted below for facility of reference.

[The Learned Commissioner quoted sub-sections (1) to (5) of Sec. 66 of the Income Tax Act and proceeded:]

The judgment of the Hon'ble Mr. JUSTICE MCNAIR does not come under any of the sub-sections quoted above and my humble and respectful submission is that this being so, the Income-tax Officer is not precluded from proceeding with the re-assessment by reason of the judgment of the Hon'ble Mr. JUSTICE MCNAIR delivered on the 6th March, 1935.

3. As has already been stated, the final order made by his Lordship, the Hon'ble Mr. JUSTICE MCNAIR was one of dismissal of the application of the assessee. There was no order made by his Lordship prohibiting the Income-tax Officer from proceeding with the re-assessment. The assessee, however, seems to contend that though he failed in his attempt at getting an order of restraint or prohibition, yet the Hon'ble Mr. JUSTICE MCNAIR in his judgment delivered on the 6th March, 1935, made certain observations against the legality of the re-assessment proceedings and these observations would operate as *res judicata*, so that for the purpose of the present re-assessment proceeding these must be taken as final and binding decisions upon the matters regarding which his Lordship made them. These observations are substantially collected at pages 6 and 7 of the original Paper Book. In my humble submission those observations in the judgment of the Hon'ble Mr. JUSTICE MCNAIR or any other observation to a like effect in the said judgment cannot operate as *res judicata*. His Lordship disposed of the application of the assessee by dismissing the same and refusing to grant any of his prayers. For the purpose of this determination of the matter it was not at all necessary for his Lordship to decide any of these questions and his Lordship's decision dismissing the application was not based upon any of these observations. The assessee's application having been wholly dismissed, none of the observations made against the Income-tax authorities can, in my humble submission operate as *res judicata*. The Income-tax authorities could not have appealed from these observations, the final decision being wholly in their favour.

4. The assessee seems also to contend that the Income-tax Officer is estopped from proceeding further with the case. I must confess my inability to appreciate how estoppel comes in in this case. Certainly the Income-tax Officer made no declaration or representation to the assessee either directly or by conduct which induced him to believe that the re-assessment proceedings had been given up and on that belief to act to his prejudice. In fact the Income-tax authorities did make no declaration or representation whatsoever to the assessee and I do not think the

assessee can allege any such declaration or representation. The only other way in which the assessee can possibly plead estoppel seems to be that His Lordship Mr. Justice McNair having construed certain provisions of the Income-tax Statute in a certain way as between the parties thereto can no longer contest the construction of the statute and consequently as, on the construction put by his Lordship on Section 34 of the Indian Income-tax Act, the re-assessment proceedings as started would be illegal the Income-tax Officer is debarred from proceeding with the re-assessment. In my humble submission this is only another way of saying that the observations of his Lordship regarding the meaning and scope of Section 34 of the Indian Income-tax Act must be taken as final and a binding decision on the matter. I have already made any submission on this point while discussing the question of *res judicata* and I would respectfully contend that the observations of his Lordship Mr. JUSTICE MCNAIR regarding the meaning and scope of Section 34 of the Indian Income-tax Act will not have the binding effect specially in view of his Lordship's ultimate and actual decision of the matter which was in issue before him. In my humble opinion therefore the Income-tax Officer is not precluded from proceeding with the re-assessment by reason of the judgment delivered by the Hon'ble Mr. JUSTICE MCNAIR on the 6th day of March 1935. He is however precluded from proceeding with the re-assessment until the disposal of the reference submitted under Section 66 (1) by my predecessor dated the 20th April 1936 and of Their Lordships' decision of the question enunciated in paragraph 6 of the original Paper Book. .

Barwell and Jyotti P. Mitter, for the assessee.

A.K. Roy (Advocate-General) and *Dr. R.C. Pal*, for the Commissioner.

JUDGMENT.

DERBYSHIRE, C.J.—This Reference under Section 66 of the Indian Income-tax Act, 1922, comes before us with an unusual history. The assessee is a registered partnership firm carrying on business as general merchants in Calcutta. In the year of assessment in question from April 1, 1932, to March 31, 1933, the due date for a return to be made by the firm was July 25, 1932. The return was actually made on December 21, 1932, and it was based on the period from October 1930 to October 1931 (Dewali to Dewali). Nothing turns on the actual period. With the return was sent a copy of the Profit and Loss Account of the year which showed a loss of about eight lakhs of rupees. Between December 21 and December 28, Mr. Kanailal Jatia, a partner in the firm,

in response to a notice from the Income-tax Officer apparently under Section 22 of the Act appeared before the Income-tax Officer and produced the firm's Rokar, Nakal, and Khata and explained such items as the Income-tax Officer asked questions upon. Thereupon on December 23, 1932, the Income-tax Officer assessed the firm at *nil* and renewed the firm's registration under Section 26A of the Act.

The next return was made in November 1933, for the assessment year April 1, 1933, March 31, 1934, in respect of the period November 1931 to October 1932 (Dewali to Dewali). This particular return showed a loss of two to three lakhs of rupees. No assessment was made in respect of the year April 1, 1933, to March 31, 1934, because of an attempt made by the Income-tax Officer to reopen the assessment of the previous year—the year now in question. This came about in this way.

The Income-tax Officer, apparently at the beginning of January 1934, received information which made him suspicious as to the correctness of the previous return and thereupon he issued to the assessee on February 8, 1934, the following notice purporting to be given under Sections 34 and 22 (2) of the Act:—

“Whereas I have reason to believe that your income from business and other sources which should have been assessed in the financial year ending the 31st March 1933 has wholly escaped assessment, and I therefore propose to assess the said income that has escaped assessment, I hereby require you to deliver to me, not later than the 9th March 1934, or within 30 days of the receipt of this notice, a return in the attached form of your income from all sources which was assessable in the said year ending the 31st March 1933”.

He also called for a fresh return of income. The Income-tax Officer gave the assessee no indication as to the nature of the alleged escape from tax. Nor did he at that time indicate what were the grounds of his belief that income had escaped assessment; apparently he first mentioned his grounds of belief in the case now stated. On March 22, 1934, the assessee filed a fresh return showing exactly the same loss as before. The Income-tax Officer thereafter on May 21, 1934, issued notices under Sections 22 (4) and 22 (2) calling for accounts for the three back years and for other evidence. The Income-tax Officer alleges that the assessee has only complied in part with these notices. The assessee alleges that they have afforded the Income-tax Officer all the information that he has called for on numerous occasions, but that he unnecessarily called for the books and accounts time after time so

as to harass them in carrying on their business. They also allege that the Income-tax Commissioner had a grudge against them and has acted on allegations made by one Sharma, the Manager of Segormull Rajgoria who had brought a suit against a deceased partner of the assessee's firm, Gazanand Jatia and thereafter was at the instance of this Court prosecuted and convicted for perjury and forgery committed during the course of those proceedings. Whilst Segormull was in gaol Sharma brought criminal proceedings against the assessee alleging that they had falsified their accounts. These proceedings were dismissed by the Chief Presidency Magistrate and on appeal this Court upheld the dismissal. With a view to putting an end to what they alleged to be unreasonable treatment by the Income-tax Commissioner assessee brought proceedings before MR. JUSTICE MCNAIR sitting singly on the Original Side of this Court on January 9, 1935.

In those proceedings the assessee asked for a writ of *certiorari* addressed to the Commissioner of Income-tax directing him to bring up record of the assessment proceedings in question before the Court and also for the issue of a writ of *prohibition* in respect of further proceeding under Section 34 of the Act. There were further prayers for an injunction. MR. JUSTICE MCNAIR heard that matter on March 6, 1925, when the assessee dropped their claims to relief other than the claim to writ of prohibition. The case is reported in I.L.R. 62 Cal. 1011 (*In re Ramjidas Mahaliram*). MCNAIR, J., held that he had power in a proper case to issue a writ of *prohibition* against the Commissioner, that the issue of such a writ was discretionary and that unless the want of jurisdiction complained of was based upon a breach of a fundamental principle of justice the writ ought not to issue. He also was of opinion that the Income-tax Act provided other remedies for the assessee. Accordingly he dismissed the application and there was no appeal from his decision. In the course of his judgment MCNAIR, J., said with reference to the words in Section 34 "If income has escaped assessment....." "The Legislature in my view has provided that if a certain state of facts exists and is shown to the Income-tax Officer to exist before" he proceeds to reopen the assessment under Section 34 he shall have jurisdiction to take proceedings but not otherwise. It is not for him to decide whether the state of facts exists and if he reopens the assessment without its existence he is acting without jurisdiction."

The assessee says that that is a correct statement of the law and that the Income-tax Officer is bound by it on the principle

enunciated in *R v. Speyer* (1916) 1 K.B. 210 by LORD READING, C.J. "It is proper to assume that once the law is declared by a competent judicial authority it will be followed by the Crown". McNAIR, J., also said in the same judgment :

"The Commissioner stated in his order of the 3rd November 1934 that he was not willing at that date to interfere or take any action under Section 33 or Section 66 of the Act. In view of my decision that the proceedings by the Income-tax Officer in revision were irregular the learned Commissioner may feel called upon now to look further into the matter".

By this McNAIR, J., indicated that the Income-tax Commissioner could, under Section 33, call for the record of the assessment from his subordinates and then state a case for this Court under Section 66.

After this decision there was correspondence between the assesseees and the Income-tax authorities and the outcome of it was that the Income-tax authorities refused to look into the matter further or to stay their hands with regard to re-assessment. The assesseees thereupon commenced fresh proceedings on the Original Side of this Court before MR. JUSTICE PANCKRIDGE for the purpose, apparently, of compelling the Income-tax authorities to act in accordance with the observations, just quoted, of MR. JUSTICE McNAIR. When the matter was about to come on before MR. JUSTICE PANCKRIDGE the proceedings were compromised upon the basis that a case should be stated by the Commissioner to the Court under Section 66 of the Act. Such a case was stated and it is now before us as question No. 2. When that question came up on reference, the assesseees alleged that the question had not been stated in accordance with the compromise arrived at in the proceedings before MR. JUSTICE PANCKRIDGE and after hearing the matter for some time an order was made by the Bench dealing with it (PANCKRIDGE, J., and myself) as follows :

"That the further hearing of the said reference do stand adjourned until after the hearing of the reference with the said Commissioner of Income-tax, Bengal, agrees to make raising the question of law whether the Income-tax Officer is precluded from proceeding with the re-assessment by reason of the judgment delivered by the Hon'ble MR. JUSTICE McNAIR on the sixth day of March one thousand nine hundred and thirty-five, the parties appearing as aforesaid hereby agreeing that all questions of *res judicata* and *estoppel* be decided by the reference so to be made as aforesaid by the Commissioner of Income-tax, Bengal".

Accordingly a further question was formulated by the Income-tax Officer (2) as follows :

Question (1) "Whether the Income-tax Officer is precluded from proceeding with the re-assessment by reason of the judgment delivered by the Honourable MR. JUSTICE MCNAIR on the sixth day of March one thousand nine hundred and thirty-five".

When the reference upon the one question No. 2 came before PANCKRIDGE, J., and myself the assessee stated that they had acted honestly throughout and were willing to give the Income-tax authorities any information they desired if they would be specific. The Income-tax authorities said they had no desire to harass the assessee. Accordingly I suggested that the Income-tax authorities should be specific in their requests and should be given the information they asked for. I hoped that this would dispose of the whole matter. However nothing came of the suggestion and the parties now ask for a decision from the Court upon their rights according to law.

It is to be noted that no proceedings have been brought by the Income-tax Commissioner against the assessee under Section 52 of the Income-tax Act.

It will be convenient to set out here Question No. (2) which is as follows :

"Where the Income-tax Officer has, on such materials and information as are available to him, reason to believe that income from any of the heads of income described under Section 6 of the Indian Income-tax Act in the present instance, from 'business' and 'other sources' which should have been assessed in the year of assessment has escaped assessment and, as a result of such enquiries and investigations as are possible at that stage, has been satisfied as stated in paragraph 3 of the statement that a *prima facie* case has been made out against the assessee for assessment under Section 34 of the Act, whether on a true construction of Section 34 of the Act, it is not open for the Income tax Officer to initiate proceedings under Section 34, affording at the same time ample opportunities to the assessee to produce such evidence to the contrary as he likes, in the course of the proceedings thus initiated, or, on the other hand, does the section contemplate that the factum of such escapement should have been first proved and definitely found and determined by an independent enquiry, before the Income tax Officer can assume jurisdiction to reopen the assessment under Section 34".

We have heard the Reference with regard to both the questions at the same time. It has been contended by the assesseees that the Income tax Officer is bound by the observations of MR. JUSTICE McNAIR which were in favour of the assesseees, that he should have given effect to them and that he was estopped from putting question No. 2 for the opinion of the Court. Further, it has been contended that the matter was *res judicata* under the decision of MR. JUSTICE McNAIR.

I will proceed to deal with these arguments, MR. JUSTICE McNAIR in considering whether he should grant a writ of prohibition had of necessity to consider several sections of the Income tax Act, but his decision not to grant the writ was not based upon any consideration of Section 34. It was based upon other and quite general grounds which I have set out above.

His views upon Section 34 were not necessary for his decision. In fact his decision against the assesseees on the question of the issue of the writ was given in spite of his views on Section 34 which were favourable to them. The legal effect of views so given is, I believe, correctly stated in Halsbury's Laws of England, 2nd Edition, Vol. 19 page 252: "Statements which are not necessary to the decision, which go beyond the occasion and lay down a rule that is unnecessary for the purpose in hand have no binding authority on another Court, though they may have some merely persuasive efficacy". Consequently, I hold that the views of MR. JUSTICE McNAIR upon Section 34 of the Income tax Act do not operate as *res judicata* nor are they binding upon the Income tax authorities on the dictum of LORD READING in *R. v. Speyer* quoted above. I treat McNAIR, J's views on Section 34 which were arrived at after considerable thought, with the respect they are undoubtedly entitled to, but I arrived at a somewhat different conclusion which I state hereafter.

The Act itself by Sections 66 and 66A gives the Commissioner a clear and unqualified right to state a case for the opinion of this Court and to have it decided by a Bench of at least two Judges. The Income tax Commissioner is an official charged with certain duties as to the collection of income tax and if in the course of these duties he deems it necessary to ascertain the views of the Court upon the meaning of a section of the Act (other than one under Chapter VIII) he is entitled to state a case for the opinion of a Bench of at least two Judges of this Court. I do not see how he can be estopped from exercising that statutory right. Moreover when he has received the judgment of such a Bench of this Court

upon the case he is required by Section 66 (5) to "dispose of the case accordingly". I am, therefore, of the opinion and hold that MR. JUSTICE MCNAIR's views on Section 34 were not binding upon the Income-tax Commissioner and that the assessee's contention as to *res judicata* and estoppel fail. Therefore, the answer to question No. 1, strictly speaking, would be in the negative.

As regards question No. 2 this is not in proper form. It is made up of several involved questions connected with each other. The answers to these questions and to question No. 1 and the legal position on the whole matter is, I believe, given hereafter. When once the Income-tax Officer has made the assessment under Section 23 (1) that assessment is settled. See per *Lord Parker* in *Inland Revenue v. Brooks* (1915 Appeal Cases 478 at page 491). "It was further suggested that, on the general principles of law governing estoppels, neither the subject nor the Crown ought to be at liberty to go behind the amount of profits and gains when once determined by any competent authority. I do not dispute these general principles etc."

The assessment once made according to the provisions of the Income tax Act can only be reopened in accordance with the provisions of the Act, Section 34 says :—

"If for any reason income, profits or gains chargeable to income tax *has* escaped assessment in any year, or has been assessed at too low a rate, the Income-tax Officer may etc."

We are dealing only with the case where it is alleged that income chargeable to tax has escaped assessment. In my view it is in this case a condition precedent to the Income-tax Officer acting under Section 34 and proceeding to serve notices under Section 22 (2) that the income, profits and gains chargeable to income tax *has* escaped assessment.

Who is to decide whether such is the case? Some person or tribunal must decide the question. In my view, it is the Income tax Officer; he is the person charged with the duty of taking action under Section 34 where such action ought to be taken. Apart from the assessee, at this stage, no person other than the Income tax Officer can, by reason of Section 54 of the Act have any knowledge of the first assessment and upon what data it was based, and no one else is in a position to decide whether income has escaped assessment or not.

In *Harmukhrai Dunichand's Case* (I.L.R. 56 Cal. p. 39) RANKIN, C.J., said:

"Fundamentally, no doubt the Income-tax Officer must proceed in a judicial spirit and come to a judicial conclusion upon properly ascertained facts, though I would point out that the Income-tax Officer is not a Court, has not the proceeding of a Court, and he is, to some extent, a party or Judge in his own case".

In deciding whether income has escaped assessment the Income tax Officer must not act on suspicion or conjecture; he must decide the question upon a fair and reasonable consideration of such information and materials as are available to him. He need not hold a formal enquiry, but he should indicate to the assessee the nature of the alleged escapement so as to enable him to identify it and explain it if he can. In other words he should give the assessee an opportunity of being heard before he decides against him that income has escaped assessment and proceeds to upset the settled assessment. If the Income tax Officer is satisfied with the assessee's explanation there is an end of the matter. On the other hand, if after a fair consideration of all the information and materials before him, including the explanation the assessee has given, or the failure of the assessee to give any explanation, of the alleged escapement, the Income-tax Officer acting as a reasonable man comes to the conclusion that income has escaped assessment he may say so, and once he has so decided he may proceed under Section 34.

In the present case the Income tax Officer stated that he "had reason to believe" that income had escaped assessment and proceeded to act under Section 34. The English Income tax Act of 1918, Section 125 which deals with re-assessment when there has been escapement from tax authorises an additional assessment if the surveyor "discovers" that income has been omitted from the first assessment. It has been held in England under the English Act that "discovers" may mean "has reason to believe". There the condition precedent to making another assessment is that the surveyor shall do something—"discovers". A discovery may be made anywhere, in the absence of, without the knowledge of, and without reference to the assessee. In the Indian Act the condition precedent is that "income has escaped". This implies a decision by someone (the Income tax Officer in my view) that "income has escaped". That in my view can only be a quasi-judicial decision by the Income tax Officer on the lines indicated above, which involves giving the assessee an opportunity of his being heard before the decision is made.

In my opinion, in this case, the condition precedent was not fulfilled since there was no proper nor indeed, any, decision by the Income tax Officer that income has escaped assessment before he purported to put Section 34 into operation. For that reason, in my opinion, the subsequent proceedings in this case were invalid.

There will be no order as to costs.

KHUNDKAR, J.—I agree.

MUKHERJEA, J.—I agree.

[IN THE PATNA HIGH COURT.]

HANUTRAM BHURAMAL

v.

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA.

SIR COURTNEY TERRELL, C.J., and JAMES, J.

January 31, 1938.

BAD DEBT—INCOME TAX AUTHORITIES MUST NOT TAKE UP INCONSISTENT POSITIONS—DEBTS TREATED AS GOOD IN ONE YEAR CANNOT SUBSEQUENTLY BE HELD TO HAVE BECOME BAD BEFORE THAT YEAR—‘DISCONTINUANCE OF BUSINESS’, MEANING OF—INDIAN INCOME TAX ACT (XI of 1922), Sec. 25.

A debt due to the assessee had been brought forward in his accounts from year to year as an asset bearing interest, and in respect of the year 1931-32, it was so treated for purposes of assessment. For the year 1932-33 the assessee claimed it as a bad debt, but the income tax authorities held that as the debt was 5 or 6 years old it must have become irrecoverable prior to 1932-33, and refused to allow the deduction claimed :

Held, that accounts of a continuing business must be treated by the income tax department in a consistent manner, and as the debt had been treated by the authorities as a good debt in 1931-32 it was not open to them to hold that it must have become bad before 1932-33.

The phrase ‘discontinuance of business’ is apt to be used in an ambiguous sense. Where a business changes hands or a partner ceases to be a partner there is no discontinuance of business but only a change in the ownership of the business.

Cases referred to :

BANSIDHAR v. COMMISSIONER OF INCOME TAX, BIHAR & ORISSA
[1934] (I.L.R. 13 Pat. 101; 2 I.T.R. 20; A.I.R. 1934 Pat. 46).

Case stated by the Commissioner of Income Tax, Bihar and Orissa, under Section 66 (3) of the Indian Income Tax Act.

The facts of the case are stated in the Statement of Case made by the Commissioner which runs as follows :—

STATEMENT OF CASE.

"In accordance with the High Court's order quoted above I have the honour to refer the following case for the decision of the Hon'ble Judges of the High Court under Section 66 (3) of the Income tax Act, XI of 1922 (hereinafter referred to as the Act).

2. Messrs. Hanutram Bhuramal (hereinafter referred to as the petitioners) were traders and merchants in Kishanganj in the district of Purnea. They carried on business in gold, silver and jute and owned house properties. Up to and including the assessment year 1932-33 they were assessed as a Hindu undivided family, the adult male members of the family consisting of Nemchand, Surajmal and Jaichandlal, sons of Hanutram, and Bhuramal, son of Bhomraj, brother of Hanutram. In 1933-34, the assessment year in respect of which the present reference has been ordered, the Income tax Officer as usual started proceedings to assess the petitioners by calling for a return of income. The notice under Section 22 (2) was served on 13th April 1933. On 12th May 1933 the petitioners filed an application for two months' time to file the return on the ground that the accounts from foreign dealers in Calcutta and other places had not yet been received. The Income tax Officer granted time till 30th June 1933. On 29th June 1933 another application for two months' more time was filed for more or less the same reason, but the Income tax Officer allowed time only till 10th July 1933. On a further application dated the 10th July 1933 the Income tax Officer allowed time till 31st July 1933 after which he stated that no further time would be granted. On 27th July 1933 another petition was filed by Surajmal, Jaichandmal and Bhuramal as proprietors of the firm of Hanutram Bhuramal in which it was stated "that on account of family dispute Babu Nemchand aforesaid has dissolved the firm since Fagoon Suddi 6 Sambat 1989 and that the account books concerning the said business have been kept in custody of Babu Ishwar Dass Thirani, Bari Kothi, Kishanganj," and that neither Babu Nemchand nor Babu Ishwar Dass Thirani would help or allow access to the accounts and it was therefore prayed that the account books be called for from Babu Ishwar Dass Thirani at the cost of the applicants. This request was not however acceded to. The next

petition of any relevancy was filed 1st on September 1933 by Surajmal as proprietor of the firm Hanutram Bhuramal. In this petition Surajmal reiterated the statement made in the petition dated the 27th July 1933, viz., "that owing to family dispute your petitioner's account books were deposited by your petitioner and Babu Nemchand co-sharer with Babu Ram Chandra Ishwar Dass of Kishanganj" and that owing to Babu Nemchand's non-co-operation in the matter and Babu Ishwar Dass's refusal to allow him access to the account books the return could not be filed. He therefore repeated his request that the accounts be called for from Babu Ishwar Dass. Three days later a petition was also received from Babu Nemchand in which he declared himself to be a co-sharer in the firm Messrs. Hanutram Bhuramal. In this petition he stated that there had been a quarrel "between myself and other my three co-sharers for separation of property" and he expressed his readiness to submit the return and asked the Income-tax Officer to fix a date. The return was eventually filed on 16th September 1933. The case was then posted to 4th November 1933 for examination of accounts and evidence. On that date a petition was filed by Surajmal, Bhuramal and Jaichandlal describing themselves as partners of the firm in which they stated that there were four partners in the firm, that is themselves and Nemchand, "that on account of some misunderstanding between the partners the partnership business was stopped in Fagoon 1989 Sambat" but that adjustment of accounts between the partners had not yet been made, that the books for the year 1989 had been handed over in an incomplete state to Babu Ishwar Dass, that after the handing over of the books to Babu Ishwar Das certain entries in respect of accounts received from outside customers relating to the account year which had to be made could not be made in the books themselves and it was therefore prayed that the parties be allowed to make these entries in the books in the presence of the Income tax Officer or that in the alternative the accounts received from these outside customers be taken into consideration along with the regular books of account in the computation of the income. The assessment was completed on 24th November 1933, the total income assessed being Rs. 32,494. The petitioners thereafter appealed to the Assistant Commissioner, Northern Range, who reduced the total income by Rs. 15,152. An extract from the Assistant Commissioner's order is filed Exhibit A.

3. The petitioners not being satisfied with the Assistant Commissioner's order filed an application before my predecessor

in which they asked that the assessment be revised under Section 33 of the Act or in the alternative that certain alleged questions of law said to arise out of the Assistant Commissioner's order be referred for the decision of the High Court under Section 66 (2). My predecessor made a small reduction in the total income but declined to refer to the High Court any of the questions formulated on the ground that the questions either did not arise out of the Assistant Commissioner's order or were not questions of law. An extract from my predecessor's order is filed Exhibit B.

The petitioners thereupon filed an application before the High Court under Section 66 (3) of the Act and I have been directed to state a case on the following questions :—

"1. Whether in the circumstances of this case the assessment was rightly made on the basis of a Hindu undivided family.

2. Whether the debt due from Nasiruddin Ahmad of Rs. 1,663 is an admissible deduction in the year of assessment.

3. Whether the first question arises out of the appellate order."

4. It will be convenient for the first and third questions to be taken up together as they relate to the same subject. Before I take up the first question however I would like here to stress the point that for the reasons given by me in my opinion on the third question this first question does not arise at all for consideration on the facts of this case.

5. **First Question.**—On the facts set out in paragraph 2 above it is clear that the petitioners had been formerly assessed as a Hindu undivided family, and that no claim had been made under Section 25-A (1) in the course of the assessment proceedings before the Income tax Officer by or on behalf of any member of the family that a partition had taken place among the members of the family. In the circumstances the Income tax Officer was bound by Section 25-A (3) of the Act to assess the petitioners for the year 1933-34 as a Hindu undivided family. Nothing that the Assistant Commissioner could say in the appellate order could override this provision of the law. I therefore submit that this question should be answered in the affirmative.

Third Question.—This question has its origin in a certain remark made by the Assistant Commissioner in his order dealing with the appeal against the assessment made by the Income tax Officer. I refer to the first three sentences in para 3 of his appellate order. The point however that I would like to make here is

that what the Assistant Commissioner said in these three sentences should strictly speaking not be regarded as part of the appellate order at all for the reason that whatever finding the Assistant Commissioner may have come to as regards the status of the petitioners after the alleged separation of Nemchand he could not alter the status of the petitioners from that of a Hindu undivided family to that of firm or other association of individuals having regard to the provisions of Section 25 A (3) of the Act. The Assistant Commissioner's remarks therefore record merely some facts of history which have no bearing on the points at issue in the appeal and cannot I venture to submit be made the subject matter of any reference to the High Court under Section 66. In my opinion therefore the answer to this question should be in the negative.

Second Question.—A sum of Rs. 1,797 including the item of Rs. 1,663 referred to in this question was claimed as deduction on account of bad debts. The answer to the question framed by the High Court therefore depends entirely upon the answer to the question whether the debt referred to became a bad debt in the year of assessment. That I respectfully submit is a question of fact; and before offering my opinion on the question which I have been ordered to answer I am constrained to submit the prayer that the Hon'ble Judges of the High Court will, before deciding upon the question, consider this preliminary point, *viz.*, whether any question of law arises at all. The records show that the Income tax Officer declined to allow the deductions claimed, as the bad debts had not been written off in the personal accounts of the debtors. The Assistant Commissioner on appeal disallowed those bad debts on the ground that they were old debts that had been coming forward for the past 5 or 6 years and that they had not been proved to have become irrecoverable in the year of account. The petitioners' present contention is that in the assessment for the year 1932-33, *i.e.*, the year prior to the year that I am dealing with, the Income-tax Officer in support of his estimate of interest accrued but not adjusted cited this debt of Rs. 1,663 as one of those in respect of which no interest had been calculated. This fact is taken by the petitioners as an admission by the Income tax Officer that this debt was found to be a good debt for the assessment year 1932-33 and that therefore it could only have become bad for the assessment year 1933-34. No such contention I may observe was raised before the Assistant Commissioner. In my opinion the petitioners' contention cannot be accepted. The fact that the Income tax Officer cited this debt of Rs. 1,663 in his 1932-33 assessment

order as a debt on which interest had not been adjusted does not, I submit, amount to an admission that this was found by the Income tax Officer to be a good debt in that year. What the Income tax Officer found in 1932-33 was that the petitioners had not been adjusting interest in many accounts as they ought to have done and he cited altogether six such cases including this debt of Rs. 1,663 as examples, adding that there were many other instances. It is not unlikely that some of the examples cited by the Income tax Officer (this one for instance) were not good examples of what the Income tax Officer was endeavouring to establish, *vis.*, that the petitioners' system of accounting for interest was irregular. The fact therefore that the Income tax Officer took this particular debt as an example of an account in which the petitioners did not adjust interest cannot be regarded as a clear finding by the Income tax Officer that the debt was a good one. This debt was probably regarded by the petitioners themselves as a good one as they had not written it off and it is on this estimation of the debt that the Income tax Officer took the account relating to this debt as an instance of the petitioners' defective system of accounting. As already stated this debt was 5 or 6 years old and had therefore become legally irrecoverable prior to the year of account for the assessment year 1933-34. Being legally irrecoverable it was also *prima facie* actually irrecoverable. The burden of proving that it was not actually irrecoverable was therefore on the petitioners and they did not discharge this burden. In the circumstances this debt cannot be regarded as a loss of the year of account. I submit that the answer to this question should be in the negative.

S. N. Basu and K. K. Banerjee, for the Assesseees.

S. M. Gupta, for the Commissioner of Income tax.

JUDGMENT.

This is the statement of a case by the Commissioner of Income tax in the matter of an assessment made upon a joint family in respect of a business carried on by them. The material facts may be very shortly stated. The family are the descendants of one Chaturbhuj who left two sons. The eldest son left three sons the eldest of whom was one Nemchand. From the younger son was descended one Bhuramal who had, in turn, two sons Sohan Lal and Puranchand. During the year of assessment Nemchand dropped out of the family business and became separate from the other members and ceased to have anything to do with the

business. The remaining members continued to carry on the family business. A great deal of discussion has taken place before us as to whether the business terminated or not. The phrase 'discontinuance of business' is apt to be used in an ambiguous sense. Business may change hands ; a partner may cease to be a partner, the business being carried on by his co-partners ; but such events do not constitute a discontinuance of the business in the sense meant in Section 25 of the Income tax Act. Such events are merely a change in the ownership of the business. The finding of fact concerning which there can be no dispute was that on the disappearance of Nemchand the business continued in the hands of the other members of the family.

Now, the first question of the Commissioner which we have to answer is whether in the circumstances of this case that assessment was rightly made on the basis of a Hindu undivided family. This question in part depends upon whether the business was the same business after as before the elimination of Nemchand or whether it was a different business, and that is a question of fact which was decided by the Assistant Commissioner and it is submitted by the Commissioner to have been so decided as a question of fact and the Commissioner rightly contends that it is merely a question of fact. But even in the circumstances the matter is not open now, whether it be a question of fact or a question of law, because the point was not raised before the Assistant Commissioner. The proper answer, in my opinion, to the direct question whether in the circumstances of this case the assessment was rightly made on the basis of a Hindu undivided family should be in the affirmative. As a matter of fact, under proper construction of the Act the present members of the family are really liable for the whole of the year under assessment in respect of the tax payable for that year ; but the department has charged them, very reasonably only with the tax for the period after disappearance of Nemchand. With this question however, we are not concerned.

The second question submitted to us relates simply to one item of the accounts. It would seem that some few years ago one Nasiruddin Ahmad became indebted to the assessee's business in respect of a sum of Rs. 1663. The account being kept on the mercantile system, this debt has been brought forward from year to year and has been treated as an asset bearing interest and income tax has been charged upon it. In respect of the year previous to the year of assessment it was so treated. The department, however, says that whereas an attempt has now been made in

respect of the year of assessment to wipe off the debt as bad and irrecoverable it should have been written off and treated as bad and irrecoverable in the previous year of assessment when it was in fact treated by the department as a still subsisting debt and as an item concerning the profits of the business it was treated as true, good and subsisting. It is rightly contended by the assessee that such treatment is inconsistent. After all the department should treat a continuing business with a continuing and consistent system of treatment of items of account and the principles which are applicable to such an item of account and such a method of treatment of accounts in a consistent manner are explained in the case of *Bansidhar v. Commissioner of Income-tax, Bihar and Orissa* (I.L.R. 13 Patna 101), the remarks at page 105 being the passage applicable. In my opinion the second question which is whether the debt due from Nasiruddin Ahmad of Rs. 1,663 is an admissible deduction in the year of assessment should be answered in the affirmative. This concludes the matters with which we have to deal.

The assessee has been successful in respect of a minor question and has been unsuccessful on the main question. We therefore, deem it right to order that the assessee shall pay to the department two-thirds of the costs with which it would otherwise be saddled and as the nearest approximation to this order we direct that he pay to the department the sum of six gold mohurs.

Order accordingly.

[IN THE LAHORE HIGH COURT].

SOM CHAND MALUK CHAND

v.

COMMISSIONER OF INCOME TAX, PUNJAB

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

January 19, 1938.

BEST JUDGMENT ASSESSMENT—MANDAMUS TO REQUIRE COMMISSIONER TO MAKE REFERENCE ON THE QUESTION WHETHER ASSESSMENT WAS ARBITRARY OR RECKLESS—PERMISSIBILITY—INHERENT POWERS OF COURT—SCOPE OF SEC. 66 (3)—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 23 (4), 27, 66 (3).

The jurisdiction of the High Court under Section 66 (3) is confined only to those matters which are contained in the application

made to the Commissioner under sub-sec. (2) of Sec. 66 and it is only in relation to such matters that the refusal of the Commissioner to state the case can be investigated by the High Court. Consequently if a point is not raised before the Commissioner, his refusal to state the case cannot be declared to be unjustified.

In the case of an assessment under Sec. 23 (4), all that can be contested before the Income-tax Officer and the Assistant Commissioner is the matter arising under Sec. 27, and all that can be mooted before the Commissioner is the matter arising out of the appellate order of the Assistant Commissioner and the High Court has therefore no power in the case of such an assessment to direct the Commissioner to state the case on the question whether the assessment was made arbitrarily, recklessly or capriciously without the Income-tax Officer exercising his judgment in the matter.

The jurisdiction exercised by the High Courts under the Income Tax Act is a special jurisdiction and is circumscribed within the limits specified in the statute. The power of revising, reviewing or interfering in any other manner with an assessment made under Sec. 23 (4) being nowhere conferred upon the High Court expressly or impliedly by the Income Tax Act, no such power can be exercised merely by virtue of the general inherent jurisdiction of the High Court, if any.

Cases referred to :

ABDUL BARI CHAUDHRI v. COMMISSIONER OF INCOME TAX, BURMA [1931] (I.L.R. 9 Rang. 281; 5 I.T.C. 352; A.I.R. 1931 Rang. 194).

COMMISSIONER OF INCOME TAX, BOM. PRES. v. BOMBAY TRUST CORPORATION LTD. [1936] (4 I.T.R. 323; 164 I.C. 18, P.C.).

COMMISSIONER OF INCOME TAX, U.P. & C.P. v. LAXMINARAIN BADRIDAS [1937] (5 I.T.R. 170; I.L.R. 1937 Nag. 191; 64 I.A. 102; 167 I.C. 793, P.C.).

MUHAMMAD HAYAT v. COMMISSIONER OF INCOME TAX, PUNJAB [1931] (I.L.R. 12 Lah. 129; 5 I.T.C. 159; A.I.R. 1931 Lah. 87; 131 I.C. 31 F.B.).

STATEMENT OF CASE.

Facts of the Case.—The assessee Messrs. Somchand-Malukchand is a Hindu undivided family. A notice under Section 22 (2) was duly served upon the assessee on 15th April, 1934. He then applied for an English form of the return in place of the Urdu form which had been supplied. The English form was

sent on 7th June, 1934. The latest date for filing the return was 14th May, 1934, as the notice under Section 22 (2) had been served on 15th April, 1934. The assessee however did not file the return and then a notice under Section 23 (4) was issued on 6th July, 1934, calling for accounts on 9th July, 1934. On 9th July 1934 Jagiwan, *Karkun* of the assessee, sent an application praying for a month's time on the ground that the account books had been sent to Botad in Kathiawar for purposes of audit. The Income-tax Officer did not grant the time prayed for, and as the notices under Sections 22 (2) and 22 (4) had not been complied with, on 14th July, 1934, he made an assessment under Section 23 (4) on a total income of Rs. 32,008 on the basis of his inquiry. It may be noted here that the Income tax Officer passed the assessment order at Camp Abohar, where the place of business of the assessee is situate. The assessment note of the Income tax Officer is Exhibit A. The sources of income of the assessee are commission, grain dealings and interest. Subsequently the assessee filed an application under Section 27 which was rejected by the Income tax Officer. The assessee thereupon preferred an appeal against the order of the Income tax Officer under Section 27, and this too, was rejected by the Assistant Commissioner. As the Income tax Officer's orders are not relevant to the question which I have been ordered to refer, I am not enclosing copies of the same. After the appeal had failed the assessee filed an application under Section 66 (2) before my predecessor (copy enclosed Exhibit B). My predecessor refused to state the case to the High Court and rejected the application by his order dated 26th May 1936 (copy enclosed Exhibit C). Thereupon the assessee filed a petition under Section 66 (3) before the High Court (Copy Ex. D.) On receipt of the notice of mandamus application my predecessor, in his letter No. S. 10 F. P. 85, dated 11th February, 1937 (copy enclosed—Exhibit E), wrote to the Deputy Registrar of the High Court saying that he did not propose to enter appearance by counsel as he was satisfied that the matter was plain upon his order of refusal then in issue.

2. **Question of Law for the decision of the Hon'ble Court.**—In their order, dated the 3rd May, 1937, the Hon'ble Judges have required me to state the case and refer it to them on the following point (*Question 1*) :—"Whether in the circumstances of this case the assessment of the petitioner was not made arbitrarily, recklessly or capriciously, without the Income tax Officer exercising his "judgment" in the matter, and is it not liable to be set aside?"

Accordingly I refer the above question for the decision of the Hon'ble Judges.

3. Opinion of the Commissioner.—Before I proceed to discuss the quantum of the assessment, I most respectfully venture to raise the question of jurisdiction of the Hon'ble High Court to decide the above point. It may be contended by the assessee that as the Department did not appear by counsel at the time of hearing of the mandamus application and as the points that I now intend to raise were not raised in my predecessor's letter No. S, 10 F.P. 35, dated 11th February, 1937, (Exhibit E), I am precluded from raising them now. I would submit that my predecessor was so much satisfied about the correctness of his own order—and in this he was perfectly justified seeing that the assessee's counsel withdrew questions (a) to (e) formulated in the mandamus application (Exhibit D)—that he overlooked the fact that question (i) formulated in the mandamus application on which the question which I have now been ordered to refer, has been based, was never raised in the application under Section 66 (2) (Exhibit B). I submit that the decision on a mandamus application is a preliminary decision which does not preclude an objection being taken on the point of jurisdiction at the time of the final hearing of the reference when both parties are fully represented. My first objection as I have already pointed out, is that the question which I have now been ordered to refer was not formulated by the assessee in his application under Section 66 (2). Section 66 (3) runs thus:—

“If on any application being made under sub-section (2) the Commissioner refuses to state the case on the ground that no question of law arises, the assessee may apply within six months from the date on which he is served with notice of the refusal to the High Court, and the High Court, if it is not satisfied of the correctness of the Commissioner's decision, may require the Commissioner to state the case and to refer it, and, on receipt of any such requisition the Commissioner shall state and refer the case accordingly.”

I submit that on a plain reading of Section 66 (3), it appears that the High Court cannot go beyond the application under Section 66 (2) for the simple reason that if a certain point was not raised before the Commissioner in the application under Section 66 (2) the order of the Commissioner rejecting the application under Section 66 (2) cannot amount to a refusal to state the case on a point which was not raised before the Commissioner.

4. My second objection is that even if an assessment under Section 23 (4) is made arbitrarily, recklessly or capriciously the proper course for the assessee to have his grievance redressed is to approach the Commissioner under Section 33, and no reference can lie to the High Court under Section 66 (2) or 66 (3). From the Judgment of the High Court, dated 3rd May, 1937 (Exhibit F), it appears that the counsel for the assessee relied upon the exception mentioned in the Full Bench decision of the Rangoon High Court in the case of *Abdul Bari Chaudhri v. Commissioner of Income tax, Burma* (V I.T.C. 352; I.L.R. 9 Rang. 281), and certain remarks made by my predecessor in his order, dated 26th May, 1936 (Exhibit C). The question referred in the Burma case was "Whether the fact that an assessment under Section 23 (4) of the Income tax Act was entirely arbitrary involves a question of law which arises out of the Assistant Commissioner's order passed in an appeal under the provisions of Section 30 (1) relating to appeals against the refusal of the Income tax Officer to make a fresh assessment under Section 27, or which the High Court is entitled to regard as ground for an order under Section 66 (3)." I am going to show that the exception on which the assessee's counsel relied is an *obiter* which has not been supported by their Lordships of the Privy Council in *Commissioner of Income tax, Central and United Provinces v. Laxmi Narain Badri Das* (V I.T.R. 170). At page 355 of V I.T.C. PAGE, C. J., has said in his opening remarks, "I do not suggest that hard or unconscionable assessments have in fact been made, or that there is any reason to suppose that the income tax authorities in Burma do not perform their duty with fairness and to the best of their ability, but the existence of the disquiet in the mind of the public to which I have referred has led to one result that is material for the purpose in hand, namely, that the High Court, at least so it appears to me, if I may say so with all respect, has endeavoured to secure the power of controlling the action of Income tax officials in making assessments by placing a construction on the provisions of the Income tax Act for which no warrant can be found in the language in which its terms are couched." He then discusses what meaning the word "arbitrary" was intended to bear in the question propounded. He says, "If the word is taken to mean that the Income tax Officer regardless of information in his possession, deliberately, recklessly or fraudulently had made an assessment under Section 23 (4) which he knows that he was not justified in making, in such circumstances and assuming that the

assessee has failed to obtain redress as provided in the Act, I should not be prepared to hold, as at present advised, apart altogether from the provisions of the Income tax Act, that this Court does not possess jurisdiction in virtue of its inherent prerogative powers to order the Income tax Officer to do his duty." After quoting some English cases the Hon'ble Chief Justice of the Rangoon High Court went on to say that he did not apprehend that the learned Judges intended the word "arbitrary" to bear this meaning in the question set out in the order of reference and that it appeared to him that their Lordships when using the word "arbitrary" intended the word to mean that the assessment "did not purport to be founded on any materials or reasons beyond the Income tax Officer's private opinion." If that was the meaning to be attributed to the word "arbitrary" in the order of the reference the Hon'ble Chief Justice was clearly of opinion that the answer to the question propounded should be in the negative. The whole of this judgment commencing from here deals with the question referred to on the assumption that the word "arbitrary" has the second meaning and the concluding portion of his judgment runs thus: "Under Section 66 (2) the assessee as therein provided may require the Commissioner of Income tax *inter alia* to 'refer to the High Court any question of law, arising out of an order of the Assistant Commissioner under Section 31,' and if the Commissioner refuses to state a case on the ground that no question of law arises, under Section 66 (3) on the assessee's application the High Court 'may require the Commissioner to state the case and to refer it.' Inasmuch as the question whether an assessment made by the Income tax Officer under Section 23 (4) is valid or not is not a question of law that arises or can arise out of an order of the Assistant Commissioner passed under Section 31, it follows that such a question cannot be made the ground for an order by the High Court under Section 66 (3) requiring the Commissioner to state a case. For the reasons that I have stated I am of opinion that the answer to each of the questions propounded is in the negative." I submit that the opening remark of the Hon'ble Chief Justice refers to his subsequent invocation of the inherent prerogative powers. The Indian Income tax Act gives a very limited jurisdiction to the High Court, and I submit that the Income tax Officer being not a court in the ordinary sense of the word the High Court cannot exercise a jurisdiction over him which has not been given to it by the Indian Income tax Act. The concluding portion of the judgment and in fact the whole of the judgment

after the reference to the exception, shows that the reference to the inherent prerogative powers is in *obiter*. In the separate judgment delivered in the same case by DUNKLEY, J., he has held that a question arising from the actual assessment under Section 23 (4) cannot be brought before the High Court under the provisions of Section 66, sub-section 2 or 3 under any circumstances, and the only question in any way connected with such an assessment which could be raised before the High Court would be a question of law arising out of the Income-tax Officer's order under Sec. 27, refusing to cancel the assessment under Section 23 (4) and to make a fresh assessment. In *Messrs. Jotram Sher Singh v. Commissioner of Income-tax, Central and United Provinces* (VII I.T.C. 173), it has been held (at page 176) that the question whether a wholly arbitrary assessment under Section 23 (4) on assumed income or on conjectural estimate thereof involves an error of law and cannot be the subject of reference under the orders of the High Court and that as the law stands, the assessee has to be content with such relief as the Commissioner may give in the exercise of his revisional powers under Section 33, which undoubtedly confers upon him a wide discretion in dealing with questions arising in the course of assessment by officers subordinate to him. In coming to this decision, the learned Judge has remarked (at page 177) that the view he has taken is in accord with *Abdul Bari Chaudhri v. Commissioner of Income-tax, Burma* (V I.T.C. 352). This judgment of the Allahabad High Court goes to show that the exception mentioned in the judgment of the Chief Justice in the Burma case is an *obiter*, as no reference to it was made in the judgment of the Allahabad High Court and the decision of the Burma High Court was taken to be the decision contained in the concluding portion of the judgment of the Hon'ble Chief Justice of the Rangoon High Court. In the case of *Laxminarain Badri Das* (V I.T.R. 170) their Lordships of the Privy Council have remarked (at page 180) that the Income-tax Officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information, that he must not act dishonestly or vindictively or capriciously because he must exercise judgment in the matter and that Section 23 (4) places the officer in the position of a person whose decision as to amount is final and subject to no appeal, but whose decision, if it can be shown to have been arrived at without an honest exercise of judgment, may be revised or reviewed by the Commissioner under the powers conferred upon that official under Section 33. In holding

that an assessment under Section 23 (4) must necessarily be guess work their Lordships of the Privy Council have found themselves in agreement with the views expressed by the Rangoon High Court in the case of *Abdul Bari Chaudhri v. Commissioner of Income-tax, Burma* (V I.T.C. 352). But this agreement does not mean that their Lordships also endorse the view of PAGE, C.J., that the High Court by virtue of its inherent prerogative powers can, under Section 66 (3), direct the Commissioner of Income-tax to refer a question regarding the quantum of an assessment made under Section 23 (4) on the ground that the assessment was made arbitrarily, recklessly or capriciously. On the other hand, their Lordships of the Privy Council have laid down, as I have already pointed out, that if it can be shown that the Income-tax Officer's decision was arrived at without an honest exercise of judgment the remedy is revision or review by the Commissioner under Section 33. This clearly negatives the exception mentioned by PAGE, C. J.

5. In case your Lordships feel that my objections regarding jurisdiction do not arise out of the question which I have been ordered to refer under Section 66 (1) I refer the following two additional questions for your Lordships' decision.

(Question 2).—The assessee not having raised in his application under Section 66 (2) any question about the quantum of Rs. 32,000 in the assessment under Section 23 (4) for 1934-35, can he subsequently raise it before the Hon'ble High Court in an application under Section 66 (3); and

(Question 3).—Assuming only for argument's sake that the assessment of the quantum of Rs. 32,000 under Section 23 (4) for 1934-35 was made arbitrarily, recklessly or capriciously, has the Hon'ble High Court any jurisdiction to interfere with the assessment by issuing a mandamus under Section 66 (3)?

6. I shall now discuss the merits of question 1 which I have been ordered to refer. At the very outset I shall submit that an assessment under Section 23 (4) cannot be made with mathematical accuracy. In the case of *Abdul Bari Chaudhri* (V I. T. C. 352) it has been held at page 356 that ex hypothesi an assessment under Section 23 (4) must be made upon inadequate materials; and that it is a mere estimate, and if it is made by the Income-tax Officer *bona fide* and to the best of his judgment (which only means as best as he can in the circumstances) the assessee who has not chosen to state an account so that the amount of profits may be strictly determined, cannot complain if a random assessment is

made, and that under Section 23 (4) the Income-tax Officer is the *persona designata* to make the assessment, and from an assessment so made no appeal lies. In the case of *Laxmi Narain Badri Das* (V. I. T. R. 170) their Lordships of the Privy Council have held (at page 180) that the Income tax Officer must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must be able to take into consideration local knowledge and repute in regard to the assessee's circumstances and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate, and though there must necessarily be guess work in the matter, it must be honest guess work and that in that sense the assessment must be to some extent arbitrary. If therefore I am able to show that the action of the Income tax Officer is not *mala fide*, that his assessment was based on local knowledge and repute of the assessee's circumstances and past assessments, I submit that the charge of arbitrary, reckless or capricious assessment will be satisfactorily met. I have already stated in para 4 that it appears from the judgment of the High Court dated the 3rd May 1937 (Exhibit F), that the counsel for the assessee relied upon certain remarks of my predecessor in his order, dated 26th May, 1936 (Exhibit C), to substantiate the charge. These remarks occur in paras 4 and 8 of my predecessor's order. It will appear from a perusal of the order that these remarks were made not in connexion with the quantum of assessment but in connection with the procedure followed by the Income-tax Officer in dealing with an adjournment application and the application under Section 27 on the question of the sufficiency of cause which prevented the assessee from complying with the notices. The order of my predecessor was on the application under Section 66 (2) and as the quantum of assessment was not at all attacked in that application, the question of the quantum was not at all discussed in my predecessor's order and therefore no remark made by him in that order can have any bearing on the question of the quantum.

7. An assessment under Section 23 (4) being necessarily a guess work the assessment note is usually short and does not contain details as in the case of an assessment under Section 23 (3). As in order to give my opinion on the question which I have been ordered to refer, it is necessary that the quantum of Rs. 32,000 should be analysed, I called for a report from the Income-tax Officer, Mr. Gurbax Singh, who had made the assessment. He has

reported that to the best of his recollection, aided by reading of the previous record, the estimate may be analysed as under :—

	Rs.
(1) 12 per cent. on the investment of Rs. 1,11,500.	13,380
(2) Grain speculation and 'Kotha' profits (profits in forward purchase and sale of ready goods stocked in godowns) made at Bhatinda Railway Station which is British territory and in the neighbouring Indian States and brought into British India, estimated on local enquiry.	10,000
(3) Average income at Abohar, excluding the income from investment mentioned in item (1)	9,000
	<hr/> 32,380

or Rs. 32,000 in round figures. Copy of the relevant portion of the Income tax Officer's report is enclosed (Exhibit G).

8. In order to find the justification for the estimate of 12 per cent. on the investment of Rs. 1,11,500, it is necessary to go into the previous history of the treatment of this investment. In the assessment for 1927-28 a sum of Rs. 6,198 was disallowed as interest paid to the proprietors. In the assessment for 1928-29 the Income tax Officer (then another gentleman) disallowed the whole claim of payment of Rs. 7,914-4-0 as interest to Messrs. Purshotamdas Surchand of Bombay on the following ground :—

"During the previous year the assessee transferred Rs. 1,11,500 from the under-mentioned accounts in his books at Abohar to Messrs. Purshotamdas Surchand of Bombay,

Rupees 40,000 from the account of the Bhura Bhai Jawa Bhai,

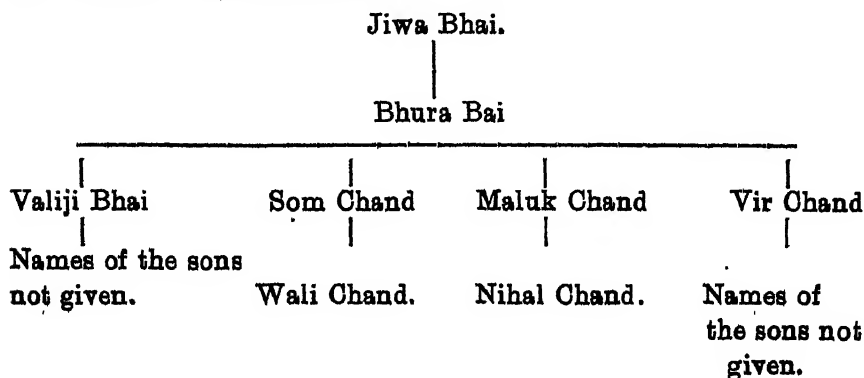
Rupees 31,500 from the account of Valiji Bhai-Bhura Bhai,
Rupees 40,000 from the account of Aminchand Munilal.

Enquiries were made from the Income-tax Officer, Bombay, requesting him to ascertain from the books of Messrs. Purshotamdas Surchand of that place whether the amount in question was credited to the accounts of the assessee in their books, and what interest if any was paid to the creditors on that amount. From the report received from the said officer it appears that the amount in question was credited under the following names :—

	Rs.
Himatlal Valiji	71,500
Bhimji Kasturchand	40,000

The local agent is unable to say definitely as to who these persons were. In my opinion they are clearly some of the proprietors. As the receipt of Rs. 7,914-4-0 is admitted on their behalf, I have no hesitation to presume that the amount represents the interest on the capital of the proprietors. The assessee only played a dodge to escape assessment on this amount. I therefore disallow it."

On appeal it was found that the firm at Bombay was neither a partner in the appellant firm nor were the two firms owned by one and the same person and furthermore the sum in question had been assessed in the hands of the Bombay firm. Accordingly the deduction claimed was allowed. As it was found that the Bombay firm had paid Rs. 1,940 and Rs. 1,600 to Himatlal Valiji and Bhimji Kasturchand, whom the Income-tax Officer held to be members of the Hindu undivided family, assessment was made under Section 34 for 1928-29 including this amount of Rs. 3,540 in the total income of the assessee. It is to be noted here that during the assessment and appellate proceedings for 1928-29 the assessee's representative did not disclose the complete genealogical tree of the family in spite of repeated adjournments. An incomplete genealogical tree was given as follows :—



The assessee's representative was unable to give the names of the sons of Valiji Bhai and Vir Chand, but in his statement before the Income-tax Officer he stated that so far as he was aware Himatlal was the son of Valiji Bhai. The assessment under Section 34 for 1928-29 was made under Section 23 (4) for default in filing the return. No objection was taken by the assessee to

the inclusion of Rs. 3,540 in the total income for 1928-29. In the assessment for 1929-30 made under Section 23 (3) the Income tax Officer again included Rs. 3,122 paid as interest by the Bombay firm to Bhimji and Valiji without any subsequent protest. This year too the assessee's representative did not supply the Income tax Officer with a genealogical tree of the family. During the assessment for 1930-31 the Income tax Officer, Bombay, reported that the account in the names of Valiji and Bhimji no longer existed in the books of the Bombay firm, Messrs. Purshotamdas Surchand. As it was not clear from the report of the Income-tax Officer, Bombay, whether the money was withdrawn or invested in some other name with Messrs. Purshotamdas Surchand and as the assessee's books at Abohar did not show any record of such investments the Income-tax Officer presumed that some interest must have been earned on these investments at Bombay and estimating interest at 6 per cent. on Rs. 1,11,500 added Rs. 6,690 to the total income for 1930-31. The assessee appealed against this decision of the Income-tax Officer, but the Assistant Commissioner upheld the order of the Income-tax Officer. The assessment for 1931-32 resulted in a net loss of Rs. 4,887 after adding Rs. 7,000 as interest on the investment of Rs. 1,11,500. In the assessment for 1932-33 it was again contended that the inclusion of this interest income was not justified. The Income tax Officer required the assessee to lead evidence on the following points :—

- (1) What is the origin of Rs. 1,11,500, the sum in question?
- (2) What are the names in which it stood in the accounts of the Abohar shop?
- (3) What is the complete pedigree-table and the evidence regarding its separation?
- (4) What are the names of the persons in whose account the sum was placed by the Bombay firm and their relationship with the family?
- (5) If the sum has since been drawn from the Bombay firm, what is the nature and manner of its re-investment?

As the assessee failed to lead evidence as required, the Income tax Officer relied upon the presumption raised in the assessment for 1930-31 and again included Rs. 6,690 in the total income. The assessee again filed an appeal, but the Assistant Commissioner upheld the decision of the Income tax Officer. It appears from the appellate order that the assessee took time to produce his books

before the Assistant Commissioner but did not turn up on the date fixed. In the assessment for 1933-34 the assessee was again given a chance for leading evidence, but he did not comply. Relying upon the decision in the *Commissioner of Income Tax, Madras v. Sankara Aiyar* (II I.T.O. 73) the Income tax Officer again included the income on this investment in the total income for 1933-34 but this time he estimated the income at 9 per cent. on the investment instead of at the previous rate of 6 per cent. on the ground that the rate of 6 per cent. had proved of no avail and it could be presumed that it was to the advantage of the assessee to be assessed on this investment at this rate. There was an appeal, but the decision of the Income tax Officer was upheld. The assessee then filed an application under Section 66 (2) before the Commissioner but the Commissioner refused to state a case. Thereupon the assessee went up to the High Court with an application under Section 66 (3) on the question of a bad debt and on the question of the rate of interest fixed on the investment of Rs. 1,11,500. In their order dated 11th June, 1936, in Civil Miscellaneous No. 168 of 1936, the Hon'ble Judges held that so far as the question regarding the rate of interest fixed on the deposit of Rs. 1,11,500 was concerned, the Income tax authorities were justified in what they did and the application was therefore rejected with respect to this question (copy of relevant portion of the order is enclosed—Exhibit H). It will thus appear that so far as this investment is concerned, the assessee has consistently tried to avoid taxation and has never placed his cards on the table. The enhancement of the rate from 5 per cent. to 9 per cent. was upheld by the Hon'ble High Court, and if following the same principle of progressive enhancement in the case of such an assessee the Income tax Officer has, in the assessment under Section 23 (4) for 1934-35, increased the rate to 12 per cent. I submit that his action is fully justified and cannot in any sense be called arbitrary, reckless or capricious.

9. The next item in the estimate is the sum of Rs. 10,000 which is made up of speculation and 'Kotha' profits made at Bhatinda Railway station which is in British territory, and such profits made in the neighbouring Indian States and brought into British India. This estimate is based on the local inquiry made by the Income Tax Officer. In the assessment order for 1934-35 (Exhibit A) the Income tax Officer has noted that an inquiry was made. In the order dated 9th July, 1934, in the order sheet also it was noted "Case for inquiries". Further in the assessment

order itself Camp Abohar is noted as the place where the Income tax Officer made the assessment. Abohar is the place of the assessee's business in British India. It cannot, therefore, be doubted that the Income tax Officer did hold a local enquiry about the income of the assessee. The Income tax Officer did not record the details and results of his inquiry but it has been held (at page 181) by their Lordships of the Privy Council in the case of *Laxminarain Badri Das* (V I.T.R. 170) that there is no justification in the language of the Act for holding that an assessment made by an officer under Section 23 (4) without conducting a local enquiry and without recording the details and results of that enquiry, cannot have been made to the best of his judgment within the meaning of this section. From the appellate order for 1933-34 it appears that the assessee has business at Dhuri and Bhatinda in neighbouring Indian States. As a matter of fact, in the assessment for 1933-34 the assessee claimed losses suffered in Mansa Mandi and Bhatinda in Patiala State. There is nothing on record by which the assessee can challenge this estimate of the Income tax Officer based on his local knowledge.

10. The last item is the estimate of Rs. 9,000 as the average income at Abohar, excluding the income from investment of Rs. 1,11,500. In 1933-34 the Income-tax Officer assessed the net income from this source at Rs. 8,401. On appeal this was reduced by Rs. 117 which represented interest paid. Subsequently as the result of the mandamus application the income from this source was further reduced by allowing bad debts amounting to Rs. 776. The net income from this source was therefore ultimately fixed at Rs. 7,508. In 1932-33 the net income from this source was assessed at Rs. 9,902. In 1931-32 assessment there was a net loss of Rs. 11,887 from this source. In 1930-31 assessment there was a net loss from this source of Rs. 2,902. In 1929-30 the net income from this source was assessed at Rs. 16,475. In 1928-29 the income from this source was assessed at Rs. 2,015. It will thus appear that the income from this source shows great variation, but considering the figures of the two immediately preceding years, namely 1932-33 and 1933-34, and the fact that in 1929-30 the income reached the figure of Rs. 16,475, I submit that the estimate of the Income tax Officer cannot be called arbitrary, reckless or capricious.

11. For reasons stated above, my respectful submission is that all the three questions should be answered in the negative.

Kirparam Bajaj for the Assessee.

J. N. Aggarwal and *S. M. Sikri* for the Commissioner.

JUDGMENT.

This is a case stated under sub-section (3) of Section 66 of the Income Tax Act. The question formulated by this Court was couched in the following terms:—

“Whether in the circumstances of this case the assessment of the petitioner was not made arbitrarily, recklessly or capriciously, without the Income tax Officer exercising his ‘judgment’ in the matter, and is it not liable to be set aside?” The Commissioner has questioned the jurisdiction of this Court in entertaining a question which was not raised in the application submitted by the assessee to the Commissioner under sub-section (2) of Section 66. It may be necessary to state the facts shortly in order to appreciate the force of this objection.

The assessee did not make a return under sub-section (2) of Section 22, nor did he comply with the terms of the notice issued under sub-section (4) of the same section. Thereupon the Income tax Officer made the assessment to the best of his judgment under sub-section (4) of Section 23. The assessee applied under Section 27 for the cancellation of this assessment, but his application was disallowed. He then presented an appeal under Section 30, but the appeal too, was dismissed. He subsequently moved the Commissioner under sub-section (2) of Section 66, but the Commissioner refused to interfere with the assessment on which the assessee put in an application in this Court with the result that the question referred to above was formulated and the Commissioner was required to state the case thereon.

The question whether the assessment was arbitrary, reckless or capricious was never raised at any stage of the proceedings before the Income tax authorities and it is on this ground that the Commissioner has questioned the jurisdiction of this Court and has relied in this connection on the wording of sub-section (3) of Section 66. The material portion of this sub-section reads as follows:—

“(3). If on any application being made under sub-section (2) the Commissioner refuses to state the case on the ground that no question of law arises, the assessee may apply.....to the High Court, and the High Court, if it is not satisfied of the correctness of the Commissioner’s decision, may require the Commissioner to state the case and to refer it.....”

The Commissioner contends that the jurisdiction of the High Court is confined only to those matters which are contained in the application made to the Commissioner under sub-section (2) of Section 66 and it is only in relation to such matters that the refusal of the Commissioner to state the case can be investigated by the High Court. Consequently if a point is not raised before the Commissioner, his refusal to state the case cannot be declared to be unjustified or, in other words, his decision cannot be pronounced to be incorrect. We consider that there is much force in this contention and we have arrived at this conclusion not only on the wording of sub-section (3) of Section 66, but on consideration of the whole scheme of the Act. It is clear that no appeal is allowed from an assessment made under sub-section (4) of Section 23. The only course open to the assessee, who is assessed under that sub-section, is to approach the Income tax Officer in the first instance under Section 27 and to ask for the cancellation of the assessment made against him. In case of refusal of the Income tax Officer to accede to his request, he can move the Assistant Commissioner under sub-section (1) of Section 30. All that he can contest before these authorities is the matter arising under Section 27 and no other matter can be raised either before the Income tax Officer or before the Assistant Commissioner. Similarly, all that can be mooted before the Commissioner, is the matter arising out of the appellate order of the Assistant Commissioner and no more. If the assessee were permitted to raise questions touching the merits of the assessment before the High Court for the first time under sub-section (3) of Section 66, it would amount to allowing him to appeal against an assessment an appeal against which is expressly forbidden. We accordingly hold that no mandamus could issue to the Commissioner on the point at issue.

Counsel for the assessee concedes the legal position as explained above, but he contends that there is an inherent power vested in this Court to interfere in cases of gross injustice or capricious assessments. In support of his contention he relies on *Muhammad Hayat v. Commissioner of Income Tax, Punjab*, *Abdul Bari Chaudhri v. Commissioner of Income Tax, Burma* and *Commissioner of Income Tax, C.P. and U.P. v. Laxminarain Badridas*. But, in our opinion, none of these judgments lends any support to him. Read carefully these judgments rather go against his contention.

In *Muhammad Hayat v. Commissioner of Income Tax, Punjab* (I.L.R. 12 Lah. 129) a case decided by five Judges of this

Court—the main judgment was delivered by SIR SHADI LAL, C. J. while discussing a similar question raised before him, he observed at page 144 of the report:—

“It is true that a finding of fact recorded by him (Income tax Officer) cannot be impeached even when it is not based upon any material, nor is it open to the High Court to say with respect to a particular case that the assessment has been made contrary to the rules of justice and good conscience.”

No doubt he added: “the High Court is, however, entitled to make a pronouncement upon the meaning of Section 23, sub-section (4), and to lay down that the Income tax Officer cannot be said to make an assessment to the best of his judgment, if he is not guided by the dictates of justice and fair play. An assessment resting upon the whim and caprice of the Income tax Officer cannot be elevated to the dignity of an assessment made to the best of his judgment.”

But it is obvious that these remarks were merely intended to impress upon the minds of the Income tax Officers that while making assessments to the best of their judgment they should not be whimsical or capricious and not that the learned Judge had jurisdiction in the matter; nor did he interfere with the assessment. The conclusion at which he arrived is really contained in the earlier passage quoted above.

In *Abdul Bari Chaudhri v. Commissioner of Income Tax, Burma* (I.L.R. 9 Rang. 281) PAGE, C. J., has observed at page 294 of the report:—

“If the word (arbitrary) is taken to mean that the Income tax Officer, regardless of information in his possession, deliberately, recklessly or fraudulently has made an assessment under Section 23 (4) which he knows that he was not justified in making, in such circumstances and assuming that the assessee has failed to obtain redress as provided in the Act, I should not be prepared to hold as at present advised, apart altogether from the provisions of the Income tax Act, that this Court does not possess jurisdiction in virtue of its inherent prerogative powers to order the Income tax Officer to do his duty.”

The conclusion at which he arrived, however, is stated at page 302 of the report in the following words:—

“Under Section 66 (2) the assessee as therein provided may require the Commissioner of Income tax *inter alia* to refer to the High Court any question of law arising out of an order of the Assistant Commissioner under Section 31, and if the Commissioner

refuses to state a case on the ground that no question of law arises under Section 66 (3) on the assessee's application, the High Court may require the Commissioner to state the case and to refer it. Inasmuch as the question whether an assessment made by the Income tax Officer under Section 23 (4) is valid or not is not a question of law that arises or can arise out of an order of the Assistant Commissioner passed under Section 31, it follows that such a question cannot be made the ground for an order by the High Court under Section 66 (3) requiring the Commissioner to state a case."

His conclusions were concurred in by the other four colleagues of his who heard the case with him. Three of them merely said that they agreed, while DUNKLEY, J., appended a separate note to the main judgment, throwing further light on those conclusions.

In *Commissioner of Income Tax, C.P. & U.P., v. Laxminarain Badridas* I.L.R. 1937 Nag. 191 (corresponding to 5 I.T.R. 170) their Lordships of the Privy Council observed "their Lordships find themselves in agreement with the views expressed by the High Court at Rangoon in the case of *Abdul Bari Chaudhuri v. Commissioner of Income Tax, Burma* (I.L.R. 9 Rang. 281)". It is on this passage that counsel for the assessee has laid much stress and has argued that inasmuch as their Lordships of the Privy Council had agreed with the views expressed by the High Court at Rangoon, they impliedly accepted the views of PAGE, C. J., as stated above in respect of the inherent jurisdiction vested in the High Court to interfere in such matters. We are not, however, disposed to interpret this passage in the manner suggested by the assessee's counsel. All that this passage conveys is that their Lordships were in agreement with the conclusions at which the High Court had arrived and these conclusions made no reference to the inherent jurisdiction of the High Court. The interpretation that we place upon the passage quoted from the judgment of their Lordships of the Privy Council finds support from the fact that their Lordships stated in an earlier part of the judgment that if the assessee was given no relief under Section 27, the assessment stood as it was. Reference in this connection may be made to 7 I. T. C. 173. In that case it was held that the High Court had no power under Section 66 (3) to require the Commissioner of Income tax to state the case on the question whether the assessment, being purely arbitrary and based on no materials whatever, was justified in point of law.

The jurisdiction exercised by the High Court under the Income Tax Act is a special jurisdiction as remaked by their

Lordships of the Privy Council in 4 I.T.R. 323 at page 339 and is consequently circumscribed within the limits specified in the Statute. The power of revising, reviewing or interfering in any other manner with an assessment made under Section 23 (4) being nowhere conferred upon the High Court expressly or impliedly by the Income tax Act, no such power can be exercised merely by virtue of the general inherent jurisdiction of the High Court, if any.

In view of our decision on the preliminary objection raised by the Commissioner, the question need not be answered; but even if it were permissible to us to consider the merits of the case we would have no hesitation in holding that the order was neither arbitrary nor reckless nor capricious, and would thus have answered the question formulated by this Court in the affirmative.

The assessee will pay the costs of this reference to the Commissioner of Income tax.

Reference answered accordingly.

[IN THE CALCUTTA HIGH COURT].

MADAN MOHAN MULLICK AND BROTHERS, *In re*.

SIR HAROLD DERBYSHIRE, C. J., KHUNDKHAR, J., and
MUKHERJEA, J.

January 12, 1938.

INCOME—MAINTENANCE ALLOWANCE PAID TO SETTLOR'S WIDOW UNDER SETTLEMENT DEED—WHETHER DEDUCTIBLE IN ASSESSING INCOME OF SETTLOR'S DESCENDANTS—ALLOCATION OF REVENUE OR APPLICATION OF INCOME.

A settlement deed provided inter alia that after the demise of the Settlor, so long as his wife S was alive she would be entitled to reside at the family dwelling house of the Settlor and her maintenance will be paid out of income of the estate of the Settlor. After the death of the Settlor the estate vested in the assessee, the descendants of the Settlor, who formed a Hindu undivided family :

Held, that in computing the income of the assessee chargeable to tax the maintenance allowance paid to the Settlor's widow under the terms of the settlement deed should be excluded, in accordance with the principle of Bejoy Singh Dhudhuria's case.

Case referred to :

BEJOY SINGH DHUDHURIA *In re* [1938] (60 I.A. 196; 1 I.T.R. 135; 60 Cal. 1029; 6 I.T.O. 449 P.C.).

Case stated by the Commissioner of Income tax, Bengal, under Section 66 (2) of the Indian Income Tax Act (XI of 1922).

STATEMENT OF CASE.

“ At the request of the assessee, a Hindu undivided family, the following statement of case is drawn up and submitted for the decision of their Lordships under Section 66 (2) of the Income tax Act on the question of law formulated in paragraph 3 below. The matter relates to the assessment for the year 1936-37 on income from house property, business and other sources, the total income being Rs. 69,809 comprising the following :—

	Rs.
House property	26,751
Business	18,661
Other sources	24,397

2. **Facts of the Case.**—The facts of the case are that one Mati Lal Mullick made a trust deed, dated the 15th July 1927, in which among other stipulations he directed that so long as his wife Sreemati Soudamini Dassi would be alive she would be entitled to reside in the dwelling house and her maintenance would be paid out of the income of the estate. Mati Lal died on the 10th August 1927 and his estate is now in the hands of the assessee the descendants of Mati Lal forming a Hindu undivided family. The relevant clauses of the Trust are quoted below :—

“ 1. That the said Trustees will realise the rent issues and all outstandings of the said estate and pay all rates, taxes and impositions payable by the Settlor for the said estate.

2. That so long the said settlor will be alive, the Trustees will monthly and every month on the First day of the succeeding month pay to settlor the net income realised in the preceding month.

3. That after the demise of the said Settlor so long the said Sreemati Soudamini Dassi will be alive she will be entitled to reside at the dwelling house and her maintenance will be paid out of the income of the said estate and the trustees will pay her the sum of Rupees five thousand for pilgrimage and the sum of Rupees fifty thousand in Government securities for her own absolute use and it is hereby declared that the jewelleryes now with the said Sreemati Soudamini Dassi will be kept by her until the said Trustees pay her a further sum of Rupees ten thousand out of the estate. On such payment the said Sreemati Soudamini Dassi shall

make over the said jewelleryes to the said Trustees and the same shall form a part of the Trust property ”.

It will be seen that there is no mention of any definite sum to be paid as maintenance allowance to the said Soudamini Dassi. Before the Income Tax Officer as also before the Assistant Commissioner of Income Tax a sum of Rs. 3,600 was claimed as a deduction from the income of the assessee on the ground that this sum was never the income of the assessee, it having been diverted before it became their income within the principle laid down in *Bejoy Singh Dudhuria Case* (60 I.A. 196). That contention did not succeed. When the matter came up before me I caused the accounts to be further examined and have found that it is not correct that the sum of Rs. 3,600 was paid during the relevant accounting year 1342 B. S. (corresponding to the year ended 13th April, 1936). The sum actually paid is Rs. 2,100. During the preceding assessment year, *viz.*, 1935-36, a sum of Rs. 4,400 was claimed as maintenance allowance of the aforesaid lady. The amount actually paid in the relative accounting year was Rs. 3,300 but nothing was allowed in that assessment. The point at issue in this assessment now is whether the sum of Rs. 2,100 (not Rs. 3,600) should be allowed as a deduction in the assessment of the Hindu undivided family.

The assessee formulated the following questions :

A. Was it legal, in the circumstances, as stated above to disallow the sum of Rs. 3,600 payable and paid out of the income of the estate, to Sm. Soudamini Dassi in terms of the Deed of Settlement, which could not, in the circumstances, form part of the income chargeable to tax in the assessee's hands and was mere allocation out of the revenue ?

B. Could the question of the widow Sm. Soudamini Dassi being entitled to her maintenance out of the income of the Trust Estate, even if there was no such stipulation of payment in the deed, legally arise, in the circumstances of the case, in the face of such a specific provision in the deed of settlement made for her ?

They do not seem to have been happily framed and as in my view the real matters at issue in this case can be covered by a single question. I propose to substitute the following question in places of the above two questions framed by the assessee :—

Whether in computing the income of the assessee chargeable to tax the maintenance allowance paid to the settlor's widow should have been treated as an allowable deduction in view of the

direction given in the Trust deed that the same will be paid out of the income of the estate.

And I respectfully refer this question only for their Lordships' decision.

4. Opinion of the Commissioner.—What the settlor stipulated is that out of the net income of the estate, the widow will have to be maintained, that is, after the income has been earned by the Hindu undivided family, the widow would be entitled to some maintenance. Soudamini lives in the same house as the members of the Hindu undivided family. In the natural course of events she as also the other members of the family will have to be maintained. The deed of trust gives her no new right. It merely describes what she already has under the Hindu law—a right of residence and suitable maintenance. It does not fix any definite sum, nor does it assure any regularity of payment. No doubt some payments were made to Soudamini for her maintenance but similar payments were also made to the four sons of the settlor, the members of the Hindu undivided family (the assessee) although not directed in the Trust deed. Moreover it has been found that these payments were made as and when money was available. If these payments to the sons not directed in the Trust deed or other expenses as per directions in the Trust deed do not come in for any exemption I do not see how payments to the widow should come in for any special treatment. Except two payments of Rs. 300 each made in November and December 1935 to the widow in which the narration in the account is "monthly allowance as per Trust deed", the entries in the accounts do not in any way connect the payments shown in the accounts with the Trust deed. Even assuming that the provision for the widow's maintenance is mandatory and not unsubstantial I would respectfully urge that it surely gives a direction regarding the manner in which some portion of the income, after being earned, is to be spent, namely towards the maintenance of the widow, but it does not follow that because of such directions that portion of the income should cease to be the income of the assessee who has the estate in his hands. The assessee is the recipient of the whole income although he may spend a part of it in the specified manner. It may be mentioned here that there are provisions in the deed for payments of monies to some other persons also, *vide* clauses 4, 5 and 6 quoted below :—

"4. That the Trustees will pay out of the estate in Government securities the sum of Rupees five thousand to the wife of each of the said Murary Mohan, Madan Mohan, Pyari Mohan and

Kartick Mohan. That the said Trustees will pay Rupees two thousand to each of the grandsons of the said Settlor, namely, Kasinath Mullick and Gora Chand Mullick and also pay the further sum of Rupees five thousand as dowry to the said Kasinath Mullick at the time of his marriage. 6. That the said Trustees will pay out of the said estate the sum of Rupees Five thousand in Government securities to each of the said daughters of the said Settlor, namely Srimati Amode Kumari, Srimati Kanchan Kumari, Srimati Santosh Kumari and Srimati Rajeswary Dassi and also to Srimati Monorama Dassi the brother's (Gopal Lal Mullick) daughter and also the like sum in like manner to Srimati Bhagabati Dassi the unmarried daughter of the Settlor five years after her marriage".

It will be noticed that as regards the payments mentioned in clauses 4, 5 and 6 above and some items in clause 3 previously quoted under paragraph 2 they are to be paid out of the estate and not out of the income, that is, the payments will be made out of the corpus. But the maintenance allowance to Soudamini Dassi is a natural item of expenditure after receipt of the income by the Hindu undivided family. That the settlor himself was conscious of this distinction is amply borne out by the expression employed by him, namely, "the maintenance will be paid out of the income of the said estate" quoted above under paragraph 2. It was argued that in accordance with the Privy Council decision in the case of *Raja Bejoy Singh Dhudhuria* the amount of allowance paid to Soudamini Dassi was diverted before it became the income of the Hindu undivided family. Facts here are different for the direction in the Trust deed is that Soudamini's maintenance will be paid out of the income, that is, after the income has been earned. The amount is not a fixed one in the deed of trust and as a matter of fact, payments do not appear to have been made of any fixed sum every year. Some money has been paid to Soudamini Dassi for her maintenance. On a somewhat analogous situation in *In re P. C. Mullick and D. C. Aich* their Lordships of the Calcutta High Court had occasion to consider the extent of the applicability of the ruling in *Raja Bejoy Singh Dhudhuria's case* when their Lordships were pleased to turn down the claim for exemption from tax of the *Sradh* expenses of the testator made as per directions in his will, holding that that was not a case of allocation of a sum out of the revenue. Conformably to the views thus expressed by their Lordships I would respectfully urge that the amount paid to the widow here cannot in the circumstances be held to be an

allocation out of revenue as in the case of *Raja Bejoy Singh Dhudhuria*. It is in my submission paid out of income after it has been earned by the Hindu undivided family. The income of the Hindu undivided family is spent not only for the maintenance of Soudamini Dassi but for various other purposes. It is now taken to be a well recognised principle of revenue law that the tax is attracted at the point when the income is earned and the department is not concerned with its subsequent destination: *Pondicherry Railway Company Limited*. I would therefore respectfully submit that the question referred to their Lordships may be answered in favour of the Revenue.

5. I append to the statement of the case copies of the following documents:—(A.) Assessment order. (B.) Grounds of Appeal. (C.) Appellate Order. (D.) Application under Section 66 (2).

JUDGMENT.

DERBYSHIRE, C. J.:—The question itself is not happily framed. But the answer I propose to give, should make the position quite clear. It is this that having regard to the provisions of clauses 3 and 12 of the deed of July 15, 1927, in computing the income of the assessees in this case chargeable to tax, the maintenance allowance paid to the Settlor's widow should have been excluded. If any legal authority is needed for that proposition it is to be found in the judgment of Lord Macmillan in the case of *Raja Bejoy Singh Dudhuria v. Commissioner of Income tax, Calcutta* (L.R. 60 I.A. 196) at the bottom of page 200 and the top of page 201.

In my opinion, if the facts had been clarified in this case, no reference would have been necessary. The fact that such was not the case appears to me to be the blame of both the parties. In my opinion there should be no order as to costs.

KHUNDKAR, J.—I agree.

MUKHERJEA, J.—I agree.

Reference answered accordingly.

[IN THE BOMBAY HIGH COURT].

MANUFACTURERS' LIFE INSURANCE CO. OF CANADA

v.

THE COMMISSIONER OF INCOME TAX, BOMBAY.

SIR JOHN BEAUMONT, C. J., and KANIA, J.

March 22, 1938.

INSURANCE COMPANY—NON-INDIAN COMPANY—MODE OF ASSESSING INCOME OF INDIAN LIFE BUSINESS—'RELIABLE DATA', MEANING OF—RECOURSE TO RULE 35, WHEN PERMISSIBLE—CALCULATION OF TOTAL INCOME—INCOME TAX AND INCOME FROM TAX FREE SECURITIES, WHETHER ALLOWABLE—INDIAN INCOME TAX RULES, R. 35—INCOME TAX ACT (XI OF 1922), SEC. 66—REFERENCE—WHETHER DATA ARE RELIABLE—QUESTION OF LAW.

A company carrying on life insurance business in India and having its head office in Canada submitted a statement of profit and loss in the normal form of a revenue account of a life insurance company showing certain actuarial estimates of the life insurance liabilities instead of the life assurance fund at the beginning and the end of the period of account, and contended that this statement contained reliable data which precluded the income tax authorities from applying Rule 35 of the Income Tax Rules: Held—that the data given in the statement were not 'reliable data' for ascertaining the profits of the Indian business of the company, and the income tax authorities were justified in resorting to the provisions of Rule 35.

In computing the total income of a company for the purposes of applying Rule 35, the entire income tax payable by the company must be included, not the Indian income tax alone.

But income derived from tax-free securities ought not to be included in assessing the total income of the company.

Whether one set of data is more reliable than another set of data for the purposes of Rule 35 is a matter of law.

Cases referred to:

NATIONAL MUTUAL LIFE ASSOCIATION v. COMMISSIONER OF INCOME TAX, BOMBAY [1936] (63 I.A. 99; 4 I.T.R. 44).

NORTHERN INSURANCE CO. v. RUSSEL [1889] (2 Tax Cas. 551).

NORTH BRITISH & MERCANTILE INSURANCE CO. LTD., IN RE, [1937] (I.L.R. 2 Cal. 540; 5 I.T.R. 349).

In the matter of the Indian Income-tax Act of 1922, and In the matter of the Income-tax and Super-tax Assessments of the Manufacturers' Life Insurance Co., of Canada for the year 1935-36.

The Commissioner's statement of the case was as follows :—
“ MY LORDS,

Under Section 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as “ the Act ”) and at the instance of the Manufacturers' Life Insurance Company of Canada (hereinafter referred to as “ the assessee Company ”), I have the honour to refer for your Lordships' decision the questions of law set out in paragraph 6 below, which have arisen out of the income-tax and super-tax assessments of the assessee company for the financial year 1935-36 ended on 31st March 1936.

2. **Facts of the Case.**—The assessee company is a foreign insurance company carrying on life insurance business in various parts of the world with its head office at Toronto in Canada. The assessment in dispute is for the financial year 1935-36, ended on 31st March 1936 and for the purpose thereof, the Income-tax Officer, Companies Circle, Bombay, issued a notice on 10th May 1935, reminding the assessee company of its obligation to file a return in the prescribed form under Section 22 (1) of the Act. Instead of submitting the return duly filled in, it sent with its letter dated 20th December 1935 a statement styled “ Statement of Profit and Loss arising from business transacted in the Empire of India, for the year ended 31st December 1934 ” showing a net loss of Rs. 2,79,623. A copy of the said statement dated 8th May 1935 is annexed hereto and marked Exhibit A. On receipt thereof, the Income-tax Officer, by his letter dated 23rd January 1936, requested the assessee company to submit a return of income in the prescribed form along with a copy of the Balance Sheet and Revenue Account of the Head Office for the year 1934 and details of certain items shown in the above statement (Exhibit A). In reply, the assessee company submitted the return duly completed showing a loss of Rs. 2,05,045 and a copy of the forty-eighth Annual Report in respect of the total world business for the year ended 31st December 1934. Copies of the said return and Annual Report are annexed hereto and marked Exhibits B and C respectively.

3. A scrutiny of the Statement of Profit and Loss for the Indian business (Exhibit A) showed that the assessee company had got no separate figure of the Life Fund for the British Indian

Branches. In the said statement, it had merely added to the present value of liabilities under contracts with policy-holders as on 31st December 1933 its premium income and an estimate on account of interest income and deducted therefrom the present value of liabilities on 31st December 1934 together with expenses and payments on account of death claims and bonuses and the result was put down as a loss in the Indian business. As the business done was that of life assurance, the Income-tax Officer considered that the only possible way to determine the profits earned was by an actuarial valuation under which the figure of profit earned is arrived at by deducting from the figure of the Life Fund, the total liabilities under the existing contracts with policy-holders. Mr. Rowan, the Manager of the assessee company, who attended before the above Officer in the course of the assessment proceeding was therefore asked to furnish the above figures for the British Indian business but the said Manager expressed his inability to supply the figure of the Life Fund stating that a separate Life Fund for India was not maintained and that only the figure of the Fund for the total world business was available. As the separate figure of the Life Fund for the Indian business was absolutely necessary to arrive at the profit earned and as that vital figure was not available, the Income-tax Officer was unable to arrive at the profit earned from the data furnished in the Statement, Exhibit A. Hence he applied the provisions of Rule 35 of the Income-tax Rules made under Section 59 of the Act by the Central Board of Revenue and made his assessment on the proportion of the total income, profits and gains of the assessee company for its total world business, corresponding to the proportion which its Indian premium income bore to the total premium income. He thus arrived at a total profit of Rs. 8,08,357 as under :—

(1) Premium income of the assessee company as a whole for the year ended 31st December 1934 (dollars 18,873,755 at Re. 1 for .365 dollar) ...	Rs. 5,17,08,918
(2) Premium income of the assessee company in British India for the same period...	Rs. 49,11,775
(3) Net assessable profit of the assessee company as a whole for the same period...	Rs. 85,10,016
Proportionate profit for British India	
	Rs. 49,11,775
	— of Rs. 85,10,016
	Rs. 5,17,08,918
	Rs. 8,08,375.

A copy of the Income-tax Officer's Assessment Order dated 19th March 1938 is annexed hereto, marked Exhibit D.

4. Against this assessment, the assessee company appealed to the Assistant Commissioner of Income-tax, B Division, Bombay, under a petition of appeal dated 22nd April 1936, a copy of which is annexed hereto, marked Exhibit E. The point raised in appeal was that the Income-tax Officer was not justified in resorting to Rule 35 and that the Statement furnished (Exhibit A) should have been accepted. Before the appellate officer, however, the assessee company put in another Statement of Profit and Loss (copy annexed hereto and marked Exhibit F) in which it worked out a loss of Rs. 2,16,909-15-0, as against the loss of Rs. 2,79,623-5-0 shown in the Statement, Exhibit A, which was put in before the Income-tax Officer. In the second statement, an attempt to work out the amount of the Life Fund on December 31, 1933, and December 31, 1934, was made by adding to the figure of net liability various sums of money which the Assistant Commissioner found to be not actuals but mere estimates made from the actuals for the total world business. His finding as regards that Statement as well as the Statement put in before the Income-tax Officer was that they were both "only nominal and based on figures estimated for the Indian business from the consolidated revenue account." He also held that in the case of life insurance companies, the only reliable data for arriving at their profits was the periodical actuarial valuation and that as the assessee company did not furnish any such valuation for its Indian business, the Income-tax Officer was fully justified in applying the provisions of Rule 35. He, however, revised the actual computation of taxable income made by the Income-tax Officer on some other minor grounds with which this Reference to the Honourable Court is not concerned. A copy of the Assistant Commissioner's order dated 11th November 1936 is hereto annexed, marked Exhibit G.

5. Not satisfied with the decision of the Assistant Commissioner, the assessee company has asked me to submit this Statement of the Case to the Honourable Court under Section 66 (2) of the Act. A copy of its application under the said section is annexed hereto and marked Exhibit H.

6. Questions of Law for decision by the Honourable Court.—The assessee company has asked me to refer to your Lordships the following four questions which I submit for decision :—

(1) Whether the Income-tax Officer, Companies Circle, Bombay, was justified in law in resorting to Rule 35 of the Income-tax Rules

for the purpose of assessing the Company to income tax for the year 1935-36, having regard to the data furnished by it to that officer?

"(2) In the event of its being held that the Income tax Officer, Companies Circle, Bombay, was, in law, justified in resorting to Rule 35, whether the said rule has been properly applied?

"(3) Whether the assessment of the Company to income tax for the year 1935-36 is a legal assessment?

"(4) In the event of its being held that the assessment of the Company to income tax is not a legal assessment what in law is the correct legal assessment?"

7. Opinion of the Commissioner :—As Section 66 (2) of the Act requires me to give my opinion while submitting this reference, I beg to submit that as laid down by the Court of Exchequer (Scotland) in the case of the *Northern Insurance Co. v. Russels* (2 Tax Cases, at page 578), and very recently by the Privy Council in the case of the *National Mutual Life Association of Australasia v. The Commissioner of Income tax, Bombay* (63 Indian Appeals 99), the only reliable method by which the profits of a life Assurance Company can be ascertained is by means of a periodical actuarial valuation under which the value at the end of the actuarial period of the liabilities of the company concerned under contracts with policy-holders is computed as also the amount of Life Fund and by deducting the former from the latter, the surplus profit is arrived at. No such actuarial valuation has ever been prepared for the Indian business and, as a matter of fact, it is impossible to do so as the figure of the Life Fund for the Indian business is not at all available. For the purpose of its total world business the assessee company itself issues printed Quinquennial Valuation Reports in which this Fund is being regularly computed and is shown as Life Insurance and Annuity Fund. Thus in its last Quinquennial Report for the quinquennium ended 31st December 1933 (a copy enclosed herewith and marked Exhibit I), this Fund is shown at £22,676,370-6-5. Taking into account two other funds of £345,818 and £100,171 on account of two other minor lines of insurance business, the total fund has been computed at £23,122,359 and the total liabilities at £21,503,996. The surplus for the quinquennium is then arrived at by deducting the latter from the former figures and is worked out thus at £1,618,363. No such figure whatever of the Life Fund is available for the Indian business and so the Income tax Officer rightly considered that the true profit could not be arrived at from the Statement, Exhibit A, put in before him and

he determined the taxable income by applying Rule 35 of the Income tax Rules which is as under :—

“ 35. The total income of the Indian branches of non-resident insurance companies (Life, Marine, Fire, Accident, Burglary, Fidelity Guarantee, etc.,) in the absence of more reliable data may be deemed to be the proportion of the total income, profits or gains of the companies, corresponding to the proportion which their Indian premium income bears to their total premium income. For the purpose of this rule, the total income, profits or gains of non-resident Life Assurance Companies whose profits are periodically ascertained by actuarial valuation shall be computed in the same manner as is prescribed in rule 25 for the computation of income, profits and gains of Life Assurance Companies incorporated in British India.”

The above rule states that “ in the absence of more reliable data ”, the total income is to determine in the manner laid down therein. As stated above, the data furnished in the Statement, Exhibit A, were useless as admittedly the figure showing the amount of life Fund was not available and without that figure, no computation of profit was possible.

8. When the Income-tax Officer resorted to the above Rule 35 because the figure of Life Fund for the Indian business was not available, in the course of the appellate proceedings before the Assistant Commissioner, the assessee company worked out another “ Statement of Profit and Loss ” (Exhibit F) in which it computed the loss suffered at Rs. 2,16,909-15 as against Rs. 9,79,623-5-0 worked out in Statement, Exhibit A given to the Income-tax Officer. This fact alone would show that the methods adopted by it were necessarily fallacious as although it is suggested that this was a supplementary statement submitted only “ in an effort to meet the view point of the Income-tax Officer respecting certain features of the original return ”, the fact remains that a loss of as much as Rs. 2,79,000 was at one time worked out by these methods and a loss of Rs. 2,16,000 at another. This difference of over Rs. 62,000 in the results worked out under the methods employed by the assessee company can only mean that it was computing its income on unreliable data. All attempts to work out profit in the case of Life Assurance business without the figure of the actual amount of the Life Fund built up for the Indian business from its commencement can result only in such anomalous and fictitious results. As laid down in the judicial decisions referred to in the beginning of paragraph 7 above, there is only one reliable method to arrive

at the profit from a business of this kind and that is by deducting from the figure of the Life Fund at the end of the Valuation period, the net liability as actuarially computed.

9. To get over the above fatal defect in the data furnished by the assessee company, it attempted in the Statement (Exhibit F) put in before the Assistant Commissioner to convert the figure of the net liability into that of the Life Fund by adding to it various items. The Assistant Commissioner, however, found the items to be mere estimates and not actuals and I do not think it necessary to discuss them further because when I granted an interview to the local manager to discuss the assessment, he gave me to understand that the assessee company did not desire to rely on it any more. Also in paragraph 11 to the accompaniment to the application under Section 66 (2) (Exhibit H), it is stated that "There is a Life Fund maintained for Indian business represented by the actual actuarial valuation of its liabilities". This means that we are to take the figure of the Life Fund to be identical with the figure of the net liabilities to the policy-holders. I have not come across a Life Assurance Company which computes its Life Fund in this manner, taking the figure of its net liabilities to be identical with the figure of its Life Fund at the end of a valuation period. In the Statement, Exhibit A, which the Company placed before the Income-tax Officer, it actually worked out the figure of net liabilities on 31st December 1934 for the Indian business at Rs. 1,90,45,991-12-0. At the same time it worked out a loss of Rs. 2,79,623-5-0. If the loss be the correct and true loss suffered by the Indian business, the Life Fund on 31st December 1934 would not be the figure of net liability as argued by the company but that figure diminished by the above figure of loss, *viz.*, Rs. 2,79,623-5-0. To say that the figure of the Life Fund is equal to the figure of the net liability means that there is neither actuarial surplus nor deficit or in other words there is neither profit nor loss. The statement put in would thus be meaningless and could never be utilised to work out the true business profit and could never be regarded as supplying "reliable data" for the purpose. If the figure of net liability for the Indian business is to be taken as equal to the figure of the Life Fund, it follows that for the total world business too, the same should be done whereas in the quinquennial report referred to above (Exhibit I), the figure of the Life Fund has been actually separately computed at £ 23,122,359 whereas the figure of the net liability is computed at £ 21,503,396. The Life Fund represents the value of the assets which a Company

has with it out of which it can meet its liabilities and can never be represented by the figure of net liabilities themselves.

10. To compute its Life Fund, a Life Assurance Company adopts the following method. It takes into account the value of the Fund at the beginning of the valuation period. To that, it adds the premium income, interest income and all other receipts during the period of valuation. From the total thus arrived at, it deducts payments to policy-holders and all expenses and the balance is the amount of Life Fund at the end of the period. By this method, no Life Assurance Company arrives at its profit. What it arrives at is the Life Fund, i.e., the total value of its assets. What this assessee company has done as regards the Statement, Exhibit A, handed to the Income-tax Officer, to which it has now decided to adhere in place of Exhibit F handed to the Assistant Commissioner is to take the figure of the net liability at the end of the calendar year 1933, add to it receipts from premia and interest and other items, and deduct from the total the claims paid, all expenditure during the year 1934 as also the net liability at the end of that year. The result it calls profit or loss!

11. For the above reasons, I am respectfully of opinion that the Statements, Exhibits A and F, do not supply the data absolutely necessary to compute the income from Life Assurance business as they do not disclose the separate figure of the Life Fund for the Indian business. Hence the Income-tax Officer was justified in law in resorting to Rule 35 and the answer to question (1) must be in the affirmative. As regards question (2), the answer thereto must also be in the affirmative as the application of Rule 35 is mere mathematical work and the assessee has not pointed to me any mistakes therein. Question (3) merely asks whether the assessment is legal and in view of the answers to questions (1) and (2), answers itself in the affirmative. Question (4) does not arise as the answer to question (1) is in the affirmative.

12. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act."

Mr. F. J. Coltman and Mr. V. F. Taraporewalla with Messrs. Craigie, Blunt and Caroe, for the Assesseees.

The Advocate-General with The Government Solicitor, for the Commissioner.

JUDGMENT.

BEAUMONT, C. J.—This is a Reference made by the Commissioner of Income-tax raising in substance two questions, first of all,

whether he was justified in resorting to Rule 35 of the Income-tax Rules for the purpose of assessing the company whose income-tax was in question, and secondly, if he was right in applying the rule, whether he has applied it correctly. We are dealing here with a company which carries on life insurance business and whose head office is in Canada, the Indian business being a branch business. The year of assessment is the financial year 1935-36, and the 'previous year' is the year ending 31st December 1934. Rule 35 lays down a rough and ready method for assessing the profits of non-resident insurance companies in the absence of more reliable data. The method is to take the total world profits of the company, and then treat the Indian profits as bearing the same proportion to the total world profits as the Indian premium income bears to the total premium income. The rule, as I have said, is a rough and ready rule, and it is only applicable in the absence of more reliable data. The introduction of the comparative is not, I think, very happy, because almost any data might be more reliable than the data on which the rule of the thumb is based. But I take it the rule means that it is to be applied unless the assessee provides some reliable data on which the Income-tax Officer can make a satisfactory assessment. The question here is whether the data which the assessee has provided are reliable.

Now they have produced the quinquennial valuation for the period ending 31st December 1933. They have also produced their annual report for the year ending 31st December, 1934, with accounts attached, and they have produced the books relating to their Indian income, from which the figures supplied by them can be verified. In addition to those data they have produced Exhibit A, which is headed "Statement of profit and loss arising from business transacted in the Empire of India during the year ended 31st December 1934". The question really is whether that profit and loss account with the materials for checking the figures to which I have referred provides reliable data. It is, of course, clear that you cannot arrive at a profit and loss account in the case of life insurance business in the same way as you can in the case of a business like fire insurance dealing with annual contracts. In the case of a fire insurance business you have only got to ascertain the premium income, and interest on investments and so forth, and set off against the total receipts the working expenses and payments to policy-holders, and in the result you can get at your profit or loss. But in the case of life insurance companies, where the contracts are continuing, it is obvious that your liability

may be greater or less at the end of the year than what it was at the beginning. Therefore the method is generally adopted of taking an actuarial valuation of the business at the beginning and end of the year or period, and the ordinary form of revenue account is that given in the First Schedule to the Indian Life Insurance Companies Act, which shows on what is called the credit side the amount of life assurance fund at the beginning of the year, and on what is called the debit side the amount of life assurance fund at the end of the year. In dealing with a balance sheet there is an actuarial valuation of liabilities on the debit side, and your actual assets on the credit side. Now here Exhibit A shows as the first item on the debit side a sum of approximately Rs. 164 lakhs, which is described as the present value on 31st December 1933 of future liabilities under policies, less present value of future contributions after allowing for future expenses. As I understand it, what that really means is that it is a valuation of the Indian liabilities of the company as at the beginning of the year in question, that is the year 1934. In other words, if the company were to be wound up on the 31st December 1933, it would have to bring to India this sum of Rs. 164 lakhs in order to discharge its Indian liabilities. Then there is also included on the debit side premium income, certain interest on investments, and then the sum of Rs. 7 lakhs odd which is interest calculated on the first item of Rs. 164 lakhs at the rate of interest taken in the company's quinquennial valuation. So that the company notionally treats as brought into India the sum necessary to discharge its liabilities at the beginning of the year, and allows interest on that notional sum. Then on the credit side it shows claims of the period paid, and working expenses, and then the last item is one corresponding to the first item on the debit side, an item of Rs. 190 lakhs, which again represents the sum which would have to be brought into India as at the end of the year 1934 in order to discharge the liabilities of the company in India at that date. The company say that they do not actually constitute a life insurance fund for India, but they say that Exhibit A gives sufficient data to enable the Income-tax Officer to arrive at the true income. Admittedly he can check the figures in that statement, and the assesses point out that during the 30 years in which they have done business in India they have always submitted a statement in the form of Exhibit A, and up to the present time the Commissioner of Income-tax accepted it. However, in the year in question the Income-tax Officer refused to accept the statement, and claimed that it did not provide

reliable data. His decision was upheld by the Assistant Commissioner of Income-tax.

The question we have to decide is whether Exhibit A does provide reliable data. The Advocate-General argued in the first instance that the question is purely one of fact on which the opinion of the Income-tax Officer is conclusive. What data were actually provided is, no doubt, a question of fact. Whether one set of data is more reliable than another set of data is a matter of opinion. It is a matter on which I am disposed to think that the opinion of an accountant might well be of more value than the opinion of a Judge. But the Income-tax Act does not provide for taking anybody's opinion except that of the Court, and it being a matter of opinion on which the Court has to arrive at a conclusion, I think it must be considered as a matter of law. It was certainly so treated in the Privy Council in the case of *The National Mutual Association of Australasia Limited v. The Commissioner of Income-tax, Bombay Presidency and Aden*, (1935, 68 Indian Appeals 99).

The statement, Exhibit A, is really, as I have pointed out, a statement in the normal form of a revenue account of a life insurance company, except that instead of including the life assurance fund at the beginning and the end of the year it has included certain actuarial estimates of the life insurance liabilities. The Company says that that in effect amounts to the same thing. They are not bound to bring assets to India, and that all they need do is to disclose what their Indian liabilities are. But the answer, to my mind, is that you are dealing with a mere notional sum which has no existence in fact, instead of the life assurance fund which consists of actual assets; you are necessarily leaving out of account any rise or fall in the value of those assets during the year. But if the figures in the account were figures of actual assets, as a life assurance fund should be, it is obvious that they would vary according to the market value, and an increase or decrease in the market value of the assets representing the Rs. 164 lakhs during the year would have to be brought into account, and without that one cannot, I think, arrive at the true profits of the business, as I can see. A mere estimate of liabilities seems to me to be an insufficient substitute for the Life Assurance Fund. On that short ground, it seems to me that the Commissioner is right in saying that he has not got sufficiently reliable data to enable him to say what the profits of the Indian business of the assessee company were during the year of

assessment. That being so, he was entitled to have recourse to Rule 35.

Upon the second question, it is suggested that in having recourse to Rule 35 the Commissioner has included in the total income of the assessee company two sums which he ought not to have included. The first is a sum of over Rs. two lakhs for income-tax, and the second, a sum of Rs. 41,550 in respect of income received by the assessee from tax-free securities. With regard to the income-tax the argument is that Rule 35 provides that for the purpose of ascertaining the total income you are to act on the method prescribed in Rule 25, and as Rule 25 provides that in arriving at the income for any year you must add Indian income-tax, therefore you are precluded in a case falling under Rule 35 from adding any income-tax except Indian income-tax. The argument seems to me plainly fallacious. Rule 25 deals with life assurance companies incorporated in British India. One must apply that rule to a case falling under Rule 35 *mutatis mutandis*. The reference to Indian income-tax in Rule 25, which is dealing with Indian income, cannot cover all income-tax in a case under Rule 35, which is dealing with the world income of a company incorporated elsewhere than in India. Apart from any rule, income tax is a deduction from income. For convenience of collection the tax may be deducted before the tax-payer gets his income, but that does not alter the fact that income-tax is a deduction from income, and if you are arriving at a person's total income, you must obviously arrive at it before making any allowance for income-tax. Therefore I am of opinion that on that the Commissioner of Income-tax is right.

With regard to the other sum, Rs. 41,550, which is income of the assessee company derived from certain stocks which were issued on the terms that the income was to be free from income-tax, it is argued by the assessee company that if you base your Indian income on a proportion of the total income, and include in the total income income from these tax free securities, you are in substance including the income from tax free securities in your Indian income, and therefore you are indirectly levying tax on securities which were issued free of tax. You are not directly levying tax on the income from the securities which were issued free from tax, and I do not appreciate the argument that Rule 25 conflicts with the proviso to Section 8. We have been referred on this point to a decision of a Full Bench of the Calcutta High Court, *The North British and Mercantile Insurance Company Limited, In re* (1937,

2 Cal. 540) in which a majority of the Bench came to the conclusion in a case of this sort that income derived from tax-free securities ought not to be included in the total income of the assessee company. In dealing with a statute which covers the whole of British India it is undesirable that different High Courts should arrive at conflicting conclusions, and I think that we ought to follow on this point the judgment of the Calcutta High Court, though I must confess that I doubt if I should myself have answered the question as the Calcutta Court did.

We must therefore answer the first question raised in the affirmative, and in answer to question No. 2 we say that the rule has been rightly applied except in so far as it incorporated in the world 'total income of the assessee' the sum of Rs. 41,550 derived from tax-free securities. The answer to question No. 3 is really covered by the answers to questions Nos. 1 and 2. Question No. 4 does not arise. Assesseees to pay the costs of the Commissioner of Income-tax on the Original Side scale to be taxed by the Taxing Master less Rs. 100.

KANIA, J.—This reference involves in substance the decision of two questions, which are covered by the four questions submitted to the Court. They are, (1) whether the income-tax authorities were justified in invoking the application of Rule 35 of the Income-tax Rules for assessment of the income of the assessee company for the year 1934, and (2) whether in applying that rule and working out the figures on that basis they had acted properly.

The assessee company had been submitting its return or profit and loss statement of account for several years before this question was raised by the Income-tax authorities. Evidently, having regard to the judgment delivered in *The National Mutual Association of Australasia, Limited v. The Commissioner of Income-tax, Bombay Presidency and Aden*, (1935, 63 Indian Appeals 99) the attention of the income-tax authorities was drawn to the question whether Rule 35 was applicable to the case or not. It is clear that relying on that rule they called upon the assessee company to furnish if they thought it was possible, more reliable data. The assessee company sent a statement, which is filed as Exhibit A in this Reference. In addition it produced its annual report of the working of the whole company for the year ending 31st December 1934, and the quinquennial report, also of the whole company, up to the 31st December 1933. In Exhibit A it sets out the first item as the present value of future liabilities under policies, less

present value of future contributions, after allowing for future expenses. In other words, the first item was what it has estimated actuarially the liabilities under the existing policies at the end of 1933 after taking into consideration the expected premia less cost of recovering the same. That estimated liability was the first item of the so-called debit side. It next stated the premium receipts during the year. The third item is "Interest earned". Under that item it included two amounts in respect of interest received out of India on tax-free sterling loan, and the third item is described as follows: "Balance of interest earned on Assurance Fund in connection with Company's Indian business". On the so-called credit side it included various disbursements, expenses, and the last item was described in the following terms: "Present value, 31st December, 1934, of the future liabilities under policies less present value of future contributions after allowing for future expenses." That item was similar to the first item on the debit side for the amount.

The question which was put to the assessee company by the income-tax authorities was how this was more reliable data within the meaning of Rule 35. It appears to have been urged by the assessee company that it did not keep any Assurance Fund separately allocated to Indian business nor did it keep in India any Assurance Fund. Those answers do not appear to be relevant. The question to be answered was, "where had you shown the Assurance Fund applicable to the business in India, in the return which you had submitted?" From the annual report and the quinquennial report filed by the assessee company it is clear that in those cases they had clearly shown the Life Assurance Fund, the assets of the company consisting of investments and liabilities. In Exhibit A no such statement of Assurance Fund or investments is found. The item of Rs. 164 lakhs admittedly does not represent any fund or assets but is an actuarially estimated liability. The income-tax authorities therefore considered, in the absence of assets being shown in the statement, it cannot be considered that it was more reliable data at all. In my opinion that view is correct.

It was urged on behalf of the assessee company before us, that the first item represented the liabilities of the company at the beginning of the year, and the company had funds to meet the liability. In the same way the statement showed the liability of the company at the end of the year, and the company had funds to meet that liability. On those grounds it was contended that this

was a proper statement of account. Both these items are admittedly only actuarial estimates of their liabilities at the beginning and end of the year. The question, however, which remains unanswered by the assessee company is, "What are the assets, or what is the Life Assurance Fund from which the liabilities of the company were to be satisfied?" The only answer which Mr. Taraporewalla could give us was, that the company had funds to pay these at the beginning of the year and at the end of the year and in law they were not obliged to keep any funds in India. The latter proposition may be correct, but for the purpose of taxation, the first is no answer at all. An illustration will perhaps more clearly show that the item of interest earned is quite unreliable. The Life Assurance Fund as stated in the Indian Life Assurance Companies Act and in similar Acts applicable to the British Dominions is built up as security for the life policy-holders. The assessee company could have, as an illustration, a sum of over Rs. 2 crores of Life Assurance Fund applicable to the Indian business, and may still show correctly the first item to be Rs. 164 lakhs and odd. At the end of the year it may have that fund increased or diminished according to the fluctuations of the market, and may still urge that it had 193 lakhs and odd as liabilities. If that state of affairs existed, it had accounted only for interest not on the two crores worth of investments of assets which it held as the Life Assurance Fund for the Indian business, but only for one crore and 64 lakhs. This illustration shows that the answer the company had sufficient funds to meet its policy liabilities, as actuarially estimated, at the beginning and end of the year, is not the same thing as stating that that was the Life Assurance Fund. Under the circumstances it is clear that Exhibit A, in so far as it does not disclose in particular, any Life Assurance Fund cannot be relied upon as more reliable data for the purpose of assessing income-tax. I, therefore, agree with the conclusion of the learned Chief Justice that the answer to Question No. 1 should be that income-tax authorities, under the circumstances of the case, were justified in resorting to Rule 35 for assessing the income of the assessee for the year 1934.

As regards the second item, only two points were urged on behalf of the assessee company against the actual assessment. They were in respect of the amount of Rs. 41,550 for interest earned, but not received in India, on tax-free securities. The second item was in respect of income-tax of Rs. 2,29,034. For the reasons stated in the judgment of the learned Chief Justice I agree with

the conclusion that the first item should not have been taken into consideration in computing the profits of the assessee company for the year 1934. On the item of income-tax the conclusion of the income-tax authorities appears to be correct.

[IN THE ALLAHABAD HIGH COURT.]

SIR SUNDAR SINGH MAJITHIA, *In re.*

COLLISTER and BAJPAI, JJ.

March 9, 1938.

HINDU UNDIVIDED FAMILY—PARTIAL PARTITION WITHOUT DISRUPTION OF FAMILY—FORMATION OF FIRM FOR CARRYING ON DIVIDED BUSINESS—APPLICATION FOR REGISTRATION OF FIRM—POWER OF INCOME-TAX AUTHORITIES TO REFUSE REGISTRATION—PARTIAL PARTITION—APPLICABILITY OF SECTION 25-A—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 25-A, 26-A.

For some years a Hindu undivided family consisting of a father and 3 sons, and owning among others a sugar factory, was assessed as a Hindu undivided family in respect of its income from all its properties and businesses including the sugar factory. At the time of the assessment for the accounting year 1931-32, it was alleged that the father and sons had divided the sugar factory business among themselves in certain fixed shares, while retaining their status as a joint Hindu family in respect of the other properties and businesses, and an application was made for registration of a firm which was alleged to have come into existence in respect of the sugar factory business under a partnership deed between the father and sons dated 12th February 1933. The income-tax authorities refused to recognise the alleged partition and rejected the application for registration as a firm. On a reference by the Commissioner of Income-tax :

Held—(i) *that, if the sugar factory was the self-acquired property of the father, shares in the same could be transferred to the sons only by a registered instrument in view of the provisions of the Transfer of Property Act as the factory included buildings; (ii) that, assuming that it was joint family property, Sec. 25-A of the Income Tax Act was not applicable to cases of partial partition of family property without a disruption of the family itself and that accordingly under Sec. 25-A (3) the family in question continued to be a single unit for purposes of assessment; (iii) that*

the income tax authorities have power. when an application for registration of a firm is made, to enquire whether a genuine firm has been constituted and to refuse registration if there is no firm as contemplated by the Act.

Cases referred to :

BIRADHMAL LODHA *v.* COMMISSIONER OF INCOME TAX, U. P. & C. P. [1934] (I.L.R. 56 All. 504; 2 I.T.R. 164).

TARACHAND POHUMAL *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1936] (4 I.T.R. 313; 9 I.T.C. 256; A.I.R. 1936 Lah. 836).

Miscellaneous Case No. 728 of 1935.

STATEMENT OF CASE.

Case stated by the Commissioner of Income tax, Central and United Provinces, under Section 66 (2) of the Indian Income tax Act XI of 1922 (hereinafter referred to as the Act) at the instance of Sardar Bahadur Doctor Sir Sunder Singh Majithia, Kt., C.I.E., LL. D., assessee in the status of a Hindu undivided family (hereinafter referred to as the assessee for the decision, by the Hon'ble the High Court of Judicature at Allahabad, of questions of law, set out in paragraph 3 of this statement, arising out of the Assistant Commissioner's order under Section 31 in appeal against the assessee's assessment for the assessment year 1932-33 (hereinafter referred to as the year in dispute).

Facts of the Case.—The assessee enjoys large income from property, has deposits in banks and shares in companies, does money and grain-lending business and is interested in a sugar factory styled as the Saraiya Sugar Factory. The factory is situated in a village in the Gorakhpur District from which it derives its name. The first assessment, of which there is any record extant, was made in this case in the year 1918-19. A provisional assessment was made under the Income Tax Act of 1918 in the amount of Rs. 20,269. The factory was carried on on a modest scale in that year. For the year 1919-20 a provisional assessment was made on the basis of the actual income of 1918-19 and according to the law then in force the provisional assessment of 1918-19 was adjusted on the basis of the actual income of this year which amounted to Rs. 10,533 including the profits of the Sugar Factory. For the year 1920-21 a similar assessment was made provisionally in the amount of Rs. 19,254 and the provisional assessment of 1918-19 was adjusted. For the year 1921-22 the provisional assessment was in the amount of Rs. 46,702 and the assessment for 1920-21 was adjusted on this basis. It included Rs. 43,899 as the profits

from the Sugar Factory. In the year 1922-23 the Income tax Act of 1918 was repealed. A final assessment for this year was accordingly made in the amount of Rs. 69,907 and as provided by Section 68 thereof (since repealed by the Repealing Act XII of 1927) a final adjustment of the provisional assessment for the year 1921-22 was made in the year 1922-23 on the basis of this income. In this year it was found that the assessee had been a member of the Executive Council of the Punjab Government. It appears that a part of the assessee's income had been assessed in the Amritsar District in the year 1919-20. The Punjab record shows that the assessee was appointed a member of the Executive Council of the Punjab Government on 3rd January, 1921. The Punjab assessment for the year 1919-20 was a provisional assessment in the amount of Rs. 7,001 on the basis of the actual income of the year 1918-19. The provisional assessment for the year 1918-19 was accordingly adjusted at the same time and the assessee was required to pay Rs. 218-12-6 provisionally as the tax for 1919-20 and Rs. 118-15-5 finally on adjustment for the year 1918-19. On appeal the provisional assessment was reduced to Rs. 196-13 on an income of Rs. 6,298. I presume that the final tax for 1918-19 was in consequence re-adjusted. For the year 1920-21 the provisional assessment was levied in the amount of Rs. 6,300 and necessary adjustment was made on that footing. The provisional assessment in the Punjab for the year 1921-22 was the same as for 1920-21 except that in view of the assessee's appointment as a member of the Council, the tax was charged at the maximum rate and the tax for the preceding year was adjusted at the appropriate rate. It was in the year 1921-22 that the Punjab authorities became aware that the assessee had business at Saraiya and was assessed in the United Provinces. After necessary enquiries the Gorakhpur income was added to the Punjab income only for the assessment to super tax and not to income tax and necessary adjustment was made on 24th March, 1923. No returns of income were filed by the assessee before the Punjab authorities in any of the years mentioned above. In the assessment note for the year 1922-23 the Income tax Officer, Amritsar, complains "Sardar Bahadur has again this year not submitted a return of his income.....". The Act of 1918 had been superseded by the present Act in April, 1922. The income at Gorakhpur continued to be assessed to income tax by the Income tax Officer, Gorakhpur, but was included for Super tax purposes in the total income of the assessee by the Income tax authorities in the Punjab. The Income tax Officer,

Amritsar, determined the total income of the assessee for the assessment year 1922-23 at Rs. 1,36,907 including Rs. 60,000 as the assessee's salary taxed at source and Rs. 69,907 as the Gorakhpur income. He assessed the remaining Rs. 7,000 to income tax at the maximum rate and the entire income to super tax. The provisional assessment system had been abolished and this assessment was a final assessment for the year 1922-23. It was an assessment under Section 23 (4). The necessary adjustment under the repealed Section 63 of the Act was carried out for the year 1921-22 and with it disappeared the adjustment system under the old Act for ever. The assessee was not satisfied with the Section 23 (4) assessment. He appealed. The grounds of appeal were:

"(1) That the assessee has been wrongly assessed to S. T. (super tax) on the total of his personal income as well as his joint Hindu family income."

"(2) That the salary of Rs. 60,000 P. A. as a member of the Executive Council is his personal income and the rest Rs. 76,907 is the income of the joint family to which the assessee belongs."

"(3) That he should only be charged S. T. on Rs. 1,000 on his personal income and 1,907 on the joint Hindu family income and adjustment for the last year be also made accordingly."

It was urged on behalf of the assessee that the return had been filed before the Income tax Officer at Gorakhpur. The Assistant Commissioner, Punjab, therefore, held that the assessment was in fact under Section 23 (3). He accordingly admitted the appeal and held that the salary of the assessee was his personal income which could not be assessed along with the joint Hindu family income. He accordingly allowed Rs. 50,000 out of the salary as the free allowance from the personal income and Rs. 75,000 as that from the joint Hindu family income and reduced super-tax in each case accordingly and ordered adjustment accordingly. The adjustment was made. Subsequent assessments were made on the same footing, the personal income which was entirely the salary income being assessed in the Punjab and the joint family income at Gorakhpur until the year 1926-27 when the assessee had retired from the membership of the Council and the personal assessment ceased, as there was no personal income left to be assessed. The Punjab records were transferred to Gorakhpur. After the recovery of the residuary super-tax in 1926-27 the records were deposited. Henceforward only the joint family assessment continued at Gorakhpur. The returns of income that the assessee filed in and after the year 1923-24 were in accordance

with the decision of the Assistant Commissioner, Punjab. referred to above. This decision was the triumph of the appeal made by the assessee. In the years 1923-24 and 1924-25 there were no assessments at Gorakhpur as the assessee suffered losses. The sugar business went on growing in the meanwhile and the final assessment for the year 1925-26 (as it rested after the result of an appeal) was in the amount of Rs. 1,68,577. In 1925-26 whatever profits the assessee made were absorbed by the depreciation due to him and there was no assessable income left. In the year 1927-28 the assessment was in the small amount of Rs. 15,291. In 1928-29 it was in the amount of Rs. 83,498; in 1929-30 on Rs. 3,01,676; in 1930-31, on Rs. 1,71,056; and in 1931-32, Rs. 3,96,671. Throughout these years the assessee submitted returns on the footing that the business was that of a Hindu undivided family. The assessment orders classify it as such a family and the assessee accepts the position and does not contest the status even when he files appeals—once against the assessment for the year 1925-26 and again against that for 1931-32. The latter appeal was withdrawn and, therefore, dismissed.

The assessee's account year for the purposes of the assessment in dispute (1932-33) was the year ending 30th September, 1931. In response to a notice under Section 22 for the submission of his return of income by 10th May, 1932, or within 30 days of the receipt thereof, the assessee, on 8th May, 1932, wrote to the Income tax Officer, Gorakhpur, that the accounts had not been audited and that he would submit the return as soon as that was done. No return was received. So, on 2nd November, 1932, the Income tax Officer issued a notice under Section 22 (4) requiring the assessee to produce his accounts on 2nd December, 1932. On 26th November, 1932, the assessee replied to the notice with a letter saying that the managing proprietors of the business were away from the station and asked for some date in the month of January 1933. The Income tax Officer accordingly fixed 14th January, 1933 and informed the assessee. In reply, on 8th December, 1932, the assessee wrote back to say, with regard to the submission of the return, that the accounts were still under audit and that he would send them as soon as the "balance sheet" and "report" were received from auditors. Then in continuation of it he sent another letter on 13th January, 1933, to the following effect.

(1) Accounts for 1927-28 and 1928-29 had since been noticed to have been filed in connexion with a civil suit under appeal in a civil court at Gorakhpur.

(2) He should be obliged if the production of the other two years' accounts were postponed for a fortnight.

(3) As regards the return, the accounts had only recently been received duly audited and figures for Punjab property were awaited with the return of "our" principal from Amritsar in a week's time. The repeated requests of the assessee were allowed by the Income-tax Officer and the proceedings were postponed. On 26th January, 1933, the assessee again wrote to the Income-tax Officer regretting that the principal had left certain papers behind at Amritsar and asking for 10 days more time. The Income-tax Officer accordingly adjourned the proceedings to 13th February 1933. On this date (13th February, 1933) the assessee appeared and put in an application for the registration of the Saraiya Sugar Factory as a firm within the meaning of Section 2 (14) of the Act, accompanied by the original, and a copy, of an instrument of partnership (copied as Appendix A to this statement) which had come into existence overnight. The deed is dated the 12th February, 1933. Then on 14th February, 1933, the assessee wrote, with reference to the notice under Section 22 (2) served on him on 4th April, 1932, that he was no longer the sole owner of the Sugar Factory in view of the partnership created, that he was therefore submitting a return of his income exclusive of the income from the factory and that he was submitting application for the registration of the partnership. This application appears already to have been submitted on 13th February, 1933. On 20th February, 1933 the Income-tax Officer replied, referring to the assessee's letter of 14th February, 1933, asking whether the Sugar Factory was originally started with ancestral or self-acquired funds and whether the ancestral property had been divided and if so when and how. The assessee's reaction to this enquiry develops his case for the formation and registration of the alleged firm. I, therefore, annex a copy of his letter dated 23rd February, 1933, as Appendix B. In substance the assessee stated that the factory was started with self-acquired funds, namely, the income from his salary as the Revenue Member of the Government of the Punjab, that under the customary law applicable to his community there was no distinction between the ancestral, movable and self-acquired property, both being equally at his disposal, and that the ancestral property as such had not been divided. On 7th March, 1933, the Income-tax Officer wrote enquiring of the assessee the date of the commencement and termination of his office as a Minister of the Punjab Government and whether he had previously held any other

office. The answer to the first part of the enquiry was 3rd January, 1921 to 3rd January, 1926 and to the second part, in the negative. As this letter of 8th March, 1933 contains further relevant matter, it is copied as Appendix C. On 19th March, 1933 the Income-tax Officer thereupon issued notices under Sections 23 (2) and 22 (4) requesting the personal attendance of the assessee and production of accounts on 21st March, 1933. At the same time he asked the assessee, in the event of his personal attendance not being possible, to state in writing (1) whether the family of which the assessee was the head had been "partitioned" or not, (2) when, where and in what manner the shares in the factory assigned by him to his wife and sons as in the partition deed (Appendix A) had been conveyed and (3) whether the conveyance had been effected through any written document. The assessee did not personally attend the Income-tax Office on 21st March, 1933 and there is no written reply to the above three questions on the file. On subsequent dates, the accounts produced by his representatives were examined until 29th March, 1933, on which date the order recorded is "Accounts seen. Keep pending". Then the next order on the record is dated the 18th April, 1933 to the effect "Put up on receipt of dividend report regarding the companies in which the assessee holds shares". But on the same date (18th April, 1933) a separate notice under Section 22 (2) read with Section 34 was served on the assessee's son Sardar Kripal Singh, a return on behalf of the alleged firm was filed showing an income of Rs. 3,18,376, the firm was registered and an assessment made under Section 23 (1) accepting the amount returned and a notice of demand was served by the Income tax Officer requesting payment of the tax assessed by 30th April, 1933. A copy of his assessment order is annexed as Appendix D. The matter having subsequently come to his notice, the Assistant Commissioner on 4th June, 1933, reported to the Commissioner of the time, that the Sugar Factory should not have been assessed as a firm and requested him to quash the assessment in the exercise of his powers under Section 33 of the Act because (1) until the year before (1931-32) the assessee had been assessed as the head of a Hindu undivided family, (2) it was for the first time that in the year in dispute he declared himself to be the head of a Sikh Family of the Gill Jat tribe governed by customary law with a view to convert the "Saraiya Sugar Factory" hitherto assessed as the joint Hindu family concern into a partnership business with himself, his wife and three adult sons as partners by means of a partnership deed

executed during the concluding stages of the usual assessment, (3) the assessee declaring himself absolute owner of property acquired from the funds of the ancestral property allotted 3 annas share to his wife and 3 annas to each of his three sons in capital, the nature and extent of which was not specified in the deed, (4) the assets included a factory which was immovable property, (5) granted that the assessee was absolute owner, he could not transfer the assets verbally, the silence in the deed as regards the nature of the capital being a studied device to evade stamp duty, (6) it was worth considering, which the Income-tax Officer had not done, whether when hitherto the factory had been assessed as a joint Hindu family business it could be assessed in the year in dispute as a partnership, (7) the assessee did not anywhere state that property other than the factory had been divided or that there was disruption in the family (8) the assessee had all along obtained an allowance of Rs. 75,000 on the footing that the assessment was that of a Hindu undivided family, (9) the Income-tax Officer did not examine previous records of the case, (10) before 1926-27 the assessee used also to be assessed in the Punjab and a reference to his records of that province showed that in an appeal against the assessment for the year 1922-23 his main contention was that he was a Hindu undivided family which contention was accepted with all the advantages it gave him as regards the super-tax assessment, (11) in the return showing income of the year ending March, 1925, the assessee had described himself as a joint Hindu family (12) that was also the inference from the returns filed by his son Kripal Singh at Gorakhpur. My predecessor, on a perusal of this report, considered that the assessment had been made most hurriedly and on 6th August, 1933, issued a notice requiring the assessee to show cause on 4th September 1933, why the assessment be not revised and a *de novo* assessment ordered to be made by the Income-tax Officer. After hearing the assessee, I accordingly set aside the separate assessment of the Sugar Factory as a registered firm on 20th September, 1933 and directed the Income-tax Officer to make a fresh assessment after proper enquiry. A copy of my order will be found in Appendix E. The successor-in-office of the Income-tax Officer, who had made the assessment, accordingly proceeded to make a fresh assessment and made one on 16th December, 1933, in the status of the assessee as an individual after including the Sugar Factory income. The assessee was dissatisfied and filed two appeals (1) against the refusal to register the Sugar Factory as a firm and (2) the assessment of the entire income as that of an

individual. With the treatment of the assessee as a person other than a firm, the jurisdiction of the Income-tax Officer to register the assessee as a firm vanished and the consequent refusal to register the partnership as a firm was upheld by the Assistant Commissioner. I consider the dismissal of the appeal on this point to be in order. A copy of the grounds of appeal will be found in Appendix F and that of the Assistant Commissioner's order in Appendix G. As regards (2) the assessee raised seventeen grounds out of which Nos. 1 and 15 were withdrawn by him. The remaining fifteen grounds are copied as Appendix H. In substance they deal with the sole question what the status of the assessee in relation to the Saraiya Sugar Factory is. For reasons given in his appellate order (copied as Appendix I) dated the 10th April, 1935, the Assistant Commissioner held that the assessee was neither a firm nor an individual in relation to it, but a Hindu undivided family. He accordingly modified the super-tax assessment but not the income-tax assessment. Dissatisfied with the result of the appeals, the assessee has made two applications under Section 33 and two under Section 66 (2). Each of the two groups of applications is couched exactly in the same words and this evidently is due to the fact that in the very circumstances of this case the question of registration under Section 26 A is indissolubly bound with the status of the assessee in relation to the whole or a part of his business. If the assessee is able to establish that in either case the partnership deed (Appendix A) of 12th February, 1932, has, in fact, brought about a genuine firm, then no separate application is required in this case either under Section 33 or Section 66 (2) to secure its registration. The whole case for the refusal of the registration from the outset is based on the question whether or not the partnership deed has created a genuine firm such as is entitled to registration under Section 26-A and in the event of the assessee succeeding on this point the registration will follow as an inevitable corollary on the main question whether a genuine firm has come into existence, in view of the many complexities that arise from the repercussions of the customary law on the Hindu law as it is commonly understood I consider it eminently desirable in this case that an authoritative decision of their Lordships of the High Court were solicited. Action under Section 33 is discretionary and I consider that in this case this discretion is appropriately exercised in declining to move under that section. If as a result of the reference under section 66 (2) their Lordships come to the conclusion that the finding of the

Assistant Commissioner is wrong and that a firm has come into existence, I shall have not the slightest hesitation in directing the Income-tax Officer to register the firm and apply the decision accordingly under Section 66 (5) of the Income-tax Act. I am, therefore unable to move under Section 33 and do not consider it necessary to make two separate references to the High Court. The assessee will be refunded Rs. 100 out of the sum of Rs. 200, he has deposited for the two separate applications under Section 66 (2). A copy of the other application under Section 66 (2) made by the assessee will be found in Appendix J.

QUESTIONS FOR THE DECISION OF THE HON'BLE
THE HIGH COURT OF JUDICATURE.

3. The nine questions with their respective sub-divisions are but arguments in favour of the assessee's contentions. The point embodied in question (1) was withdrawn by the assessee from among the grounds of appeal and does not, therefore, form part of the Assistant Commissioner's order under Section 31. Even if it had not been withdrawn no question of law arises out of the discretion allowed to the Commissioner by Section 33 as to the form his order should take. The only condition precedent to the passing of such an order is that he should give the assessee a reasonable opportunity of being heard before he passes an order prejudicial to him. The facts stated above will bear out that the assessee had this opportunity, nor does the assessee deny that he had it. When it is agreed that the question of registration must follow the fortunes of the decision on the main point whether the Saraiya Sugar Factory is a firm, I do not see what point there is for reference here. Question (2) is purely a legal quibble of no substance. The order under Section 33 set aside the assessment in the status of a firm and directed a fresh assessment after full enquiry into the question whether a registrable firm had come into existence. In the original assessment which was cancelled, the existence of the firm was assumed without proper enquiry. In the course of the fresh assessment the Income-tax Officer came to the conclusion, rightly or wrongly, that no such firm had come into existence. It is only a firm which is amenable to the provisions of Section 26A. On the finding of the Income-tax Officer to the contrary the refusal to mobilise the provisions of Section 26A follows as an inevitable corollary and I see nothing wrong with the Assistant Commissioner dismissing the appeal against the order refusing registration. Out of the remaining seven questions propounded by the assessee,

it will be enough if your Lordships considered the following questions of law that I refer. In the event of a decision favourable to the assessee it will enable me to give him all the relief that he desires :

In all the circumstances of this case, having regard to the personal law governing the assessee and the requirements of the Transfer of Property Act (No. IV of 1882) and the Stamp Act (II of 1889), has the deed of partnership (Appendix A) dated the 12th February, 1933, brought into existence a genuine firm entitled to registration under the provisions of Section 26A of the Act?

4. **Opinion of the Commissioner.**—The essential facts are that the assessee is a father and three sons, Hindu undivided family of the Sher Gill Hat tribe resident in the Amritsar District in the Punjab and possessed of various kinds of joint Hindu family property, the income arising from which has so far been assessed as income of the Hindu undivided family. One of the items of the joint family property is a Sugar Factory. This factory has been started in the time of the father mentioned above but has always been treated as joint family property. The father and the sons purport to have carried out an oral partition of this particular item of property, namely, the Sugar Factory, retaining their status as a joint family and holding the rest of their properties as the properties of the Hindu undivided family. Be it noted that at this alleged partition the coparceners did not receive the shares to which they were entitled under the law but the father got a four-annas share, the three sons received a three-annas share each and their mother the remaining three-annas for life. These five persons have executed a "deed of partnership" (Appendix A) purporting to bring into existence a so-called firm capable of registration under Section 26A of the Act. The contention on behalf of the assessee now is that the income of the Sugar Factory should no longer be treated as part of the income of the Hindu undivided family but should be treated as the income of a registered firm and assessed accordingly. In view of the fact that the assessee has put his case in the alternative, it is hardly necessary to consider the propriety of the view taken by the Income-tax Officer, that the assessee was the sole proprietor of the entire concern. The Assistant Commissioner has definitely discarded his view. It will be convenient to examine the assessee's contention from both points of view that he has propounded in the alternative. The first position taken up by the assessee is that the Sugar Factory (for certain reasons the soundness of which may be assumed for the sake

of argument) is the self-acquired property of the father (Sir Sundar Singh). If it is his self-acquired property he can alienate it in any manner he likes, but there must be a proper deed of transfer evidencing the alienation. No question of partition can arise in the case of self-acquired property. It is only co-parcenary property which can be the subject of partition properly so called. Separate or self-acquired property cannot be the subject of partition. This is elementary Hindu law. Therefore, any argument based on the doctrine of partial partition is beside the point. Before that doctrine applies there must be a "joint estate." Self-acquired property is not covered by such an estate. If the Sugar Factory is the self-acquired property of the assessee, then it cannot be the subject of partition and the assessee cannot succeed on that basis. It may be pointed out that when it is said that a Hindu father can divide his self-acquired property, what is meant is that he can distribute it among his sons or give it away to his sons in any way he likes. But when the property happens to be immoveable, it can be given away only in the manner enjoined by the Transfer of Property Act. The assessee's further contention that the distribution by the father of his self-acquired property also amounts to "partition" according to the true conception of Hindu Law is not, in my opinion, sound. The authorities quoted in the Assistant Commissioner's order are not authorities for this proposition. Further if the assessee insists that the distribution of self-acquired property also partakes of the nature of partition, then the distribution ought not to be unequal but in accordance with the legal shares of persons among whom it is divided and the distribution in this case being unequal, it fails as a partition. In the alternative the assessee's contention seems to be that if this factory is held to be joint family property, there has been a partition among the co-parceners in respect of it and partial partition of joint family property is permitted. But the shares which are alleged to have been allotted to the different coparceners of this family admittedly not being in accordance with their legal shares, the alleged transaction is not a partition in law. In this view of the matter the reference to the rule that a private partition need not be by a document in writing and to the entries in the books of accounts, etc., and to the Indian Partnership Act of 1932 loses all relevance. I am accordingly of the opinion that the Sugar Factory continues to occupy the same position and status in the eye of the law as it had before and the steps taken by the assessee to bring about a change are not legally admissible. My

submission, therefore is that the question should be answered in the negative.

5. A relevant extract of the statement of the case was sent to the assessee and a copy of his "observations on the facts of the case" and suggestion as to the form of the question will be found in Appendix K. I have accordingly corrected the statement. What the assessee meant was that no distinction existed between the ancestral moveable property and self-acquired property. I do not consider any further alteration or addition of the statement of the case to be necessary.

JUDGMENT.

This is a statement of a case by the Commissioner of Income Tax, C. P. and U. P., under Section 66 (2) of the Indian Income tax Act. The reference was made at the instance of Sardar Bahadur Dr. Sir Sundar Singh Majithia, C.I.E., who is the head of an undivided Hindu family consisting of himself and his three sons.

The Commissioner states that "the assessee enjoys large income from property, has deposits in banks and shares in companies, does money and grain-lending business and is interested in a sugar factory styled as the Saraiya Sugar Factory". For several years Sir Sunder Singh was also a member of the Executive Council of the Punjab Government and drew a salary in that capacity. The assessment year with which we are concerned is 1932-33 and the accounting year ended with the 30th September 1931. The members of this family are Jats of the Sher Gill tribe in the Amritsar district in the Punjab and they are, as we have already said, an undivided Hindu family. In previous years the assessee submitted return on the footing that the business of the sugar factory was a joint family concern, but at the assessment to which this case relates it was alleged that the father and the sons had divided this business among themselves, while retaining their status as a joint Hindu family and holding all other properties as properties of the Hindu undivided family. It is said that this partition took place in September 1931, and under it the father received a four-anna share and the three sons a three-anna share each, and their mother received the remaining three-anna share for life. On the 12th February 1933, these five persons executed an instrument of partnership which is printed at page 13 and the following pages of our record. On the 13th February an application was made to the Income-tax Officer under Section 26 (A) of the Act for registration of the firm which was said to have come into existence

under this deed of partnership and for separate assessment on its basis. On the 18th April 1933, the application was allowed and assessment was made accordingly, but on the 20th September 1933, the Commissioner set aside that assessment and directed that a fresh assessment be made. Accordingly on the 16th December 1933, the Income-tax Officer made a fresh assessment, treating the assessee as an individual and including the profits from the sugar factory and the "firm" was not registered under Section 26 (A) of the Act. Two appeals were filed to the Assistant Commissioner, one being against the refusal to register the alleged firm under Section 26A and the other being against the assessment. The Assistant Commissioner upheld the order of the Income-tax Officer refusing to register the firm, but modified his assessment order by directing that the assessment should be that of a Hindu undivided family and by granting an abatement in respect to super-tax.

Thereafter an application for review was preferred to the Commissioner under Section 33 and also an application under Section 66 (2) requiring the Commissioner to refer certain questions for the decision of this Court. The Commissioner rejected the application for review, but has stated a case for our decision. The question referred to is as follows :—

"In all the circumstances of this case, having regard to the personal law governing the assessee and the requirements of the Transfer of Property Act (IV of 1882) and the Stamp Act (II of 1899) has the deed of partnership (Appendix A) dated 12-2-1933, brought into existence a genuine firm entitled to registration under the provisions of Section 26 (A) of the Act?"

Two alternative positions were taken by the assessee, one being on the basis that the sugar factory was self-acquired property of Sir Sundar Singh and the other being that it was joint ancestral property until it was partitioned preparatory to the deed of partnership.

The Commissioner, in agreement with the view expressed by the Assistant Commissioner, is of opinion that, if the sugar factory was the self-acquired property of Sir Sundar Singh, the distribution of shares on his part among his sons and his wife required to be effected by a registered instrument and that, if it was joint family property the partition was ineffectual on the ground that the shares allocated thereunder, being unequal in extent, were not legal shares as sanctioned by the Hindu law.

We will first consider the matter on the hypothesis that the Sugar factory was the self-acquired property of Sir Sundar Singh.

Learned Counsel for the assessee concedes that, if Sir Sundar Singh owned immoveable property and if he wished to include others in that ownership and if in pursuance of such wish he transferred shares in the immoveable property by distribution among his sons and his wife, a registered instrument was necessary, but he pleads that in fact no immoveable property was transferred. He contends that what was conveyed to each son and to the wife was a share in the machinery and the business only, the building or buildings being placed at the disposal of this ownership for the purpose of carrying on the business; the title in such building or buildings was reserved to himself by Sir Sundar Singh. We are referred to certain clauses in the deed of partnership at page 13. It is there recited that "whereas the first party has set up machinery for manufacture of sugar and extraction of essential oils in his estate in the Gorakhpur district at village Saraiya..... and sugar and essential oils are manufactured there.....". And further on it stated that "all the parties to this deed have already entered into a partnership to work the aforesaid sugar and oil manufacturing machinery and to carry on the business of manufacturing sugar and essential oils and to do any other business that all of them may agree to carry on for profit." It is emphasised that there is no mention of buildings in this instrument. Learned counsel for the Department concedes that in India machinery is not treated as immovable property; but he maintains that a share in the buildings also was transferred to each son and to the wife.

Condition No. 2 of the deed of partnership refers to "the shares of the aforesaid parties in the capital" and we have to determine whether the capital, so referred to, was intended to include any immoveable property such as would attract the provisions of Section 123 of the Transfer of Property Act.

As we have already said, the firm is styled "The Saraiya Sugar Factory". Having regard to the ordinary meaning of "factory" it seems to us improbable that the ownership rights of the partners of this firm would be confined to the business and machinery and would not include building in which the business is conducted and the machinery is contained. The assessment order of the 18th April 1933 relating to the Saraiya Sugar Factory shows that depreciation was claimed; and an allowance was made by the Income tax Officer on this account not only in respect to machinery, plants, wagons and furniture, but also in respect to buildings. The amounts so allowed in respect to buildings was Rs. 5,058—*vide*

page 23 of our record. No objection was apparently made that the buildings did not form part of the property of the firm, but belonged exclusively to Sir Sundar Singh, and presumably, therefore, depreciation had been actually claimed on this account as well as under other heads.

It is true that the partnership deed does not specifically mention buildings, but we are clearly of opinion that, since depreciation on account of buildings was claimed by this "firm", it must be held that, if the sugar factory was the self-acquired property of Sir Sundar Singh, shares in the buildings as well as in the business and machinery were distributed among the sons and wife of the owner. And such distribution could only be effected by means of a registered instrument.

We will now examine the matter on the assumption that the factory was joint family property until it was partitioned for the purpose of entering into a partnership. Learned Counsel for the Department concedes that, if it was joint family property, no question of the Transfer of Property Act or the Stamp Act will arise. He also concedes that there is nothing in the Hindu Law to prevent a joint family from partitioning a portion only of the property while retaining the status of an undivided family and keeping the rest of the property joint. He further concedes that there may be a partition of property in unequal shares by agreement between the members of the family. But he strenuously pleads that for the purposes of the Income-tax Act members of an undivided Hindu family cannot enter into a partnership in respect to a portion of a joint property which they have partitioned among themselves.

In the present case the status of the family is admittedly still undivided and the rest of the property—apart from the sugar factory—is still joint. Now Section 25 (A) (1) of the Income-tax Act provides that:—

"Where, at the time of making an assessment under Section 23, it is claimed by or on behalf of any member of a Hindu family hitherto assessed as undivided that a partition has taken place among the members of such family, the Income-tax Officer shall make such inquiry thereinto as he may think fit, and if he is satisfied that a separation of the members of the family has taken place and that the joint family property has been partitioned among the various members or groups of members in definite portions he shall record an order to that effect ;

Provided that no such order shall be recorded until notices of the enquiry have been served on all the members of the family."

Sub-section (3) of that Section provides that :

"Where such an order has not been passed in respect of a Hindu family hitherto assessed as undivided, such family shall be deemed, for the purposes of this Act, to continue to be a Hindu undivided family."

In our opinion, the language of this section makes it perfectly clear that an order declaring separation shall only be passed if (1) the members of the family have separated in status from each other and (2) there has been a partition of all the joint family property. In *Biradhmah Lodha v. The Commissioner of Income-tax* (I.L.R. 56 All. p. 504) it was held by a Bench of this Court that Section 25 (A) of the Income-tax Act has no application in the case of a partial division of a joint family property. At page 509 BENNET, J., observed :—

"I consider that.....Section 25 (A) does not refer to a case like the present where there is an allegation that there was no partition in the joint family but there was merely a division of a particular portion of the joint family property among the various members. Therefore, the answer to the first question is in the negative, and is that in the case of a partial division of a joint family property Section 25 (A) has no application."

Similarly at page 519 NIAMATULLAH, J., said :—

"Whether the transaction be styled as one of partial partition of the family property or as transfer of part of the family property Section 25 (A) of the Income-tax Act does not, in my opinion apply. That section contemplates a case in which a disruption of the family occurs, so that a joint family, as such ceases to exist and no property previously belonging to it retains the character of joint family property."

If we may respectfully say so, we are in full agreement with that view and we are of opinion that, in the circumstances of the case before us, the family continues to be a single unit for the purposes of assessment under the Income-tax Act.

Sir Tej Bahadur Sapru, on behalf of the assessee, has argued that, as soon as the application for registration was made on the 13th February 1938, under Section 26 (A) it was the duty of the Income-tax Officer to register it forthwith; it was not open to him to make any inquiry as to the validity of the firm for the

purposes of the Income Tax Act. This argument is founded on the mandatory terms of rule No. 4 of the Rules of the Board of Inland Revenue issued under Notification No. 3 I.T., dated the 1st April, 1932, as subsequently amended. That rule reads as follows :—

“(1) On the production of the original instrument of partnership or on the acceptance by the Income-tax Officer of a certified copy thereof, the Income-tax Officer shall enter in writing at the foot of the instrument or copy, as the case may be, the following certificate, namely :—

“This instrument of partnership (or this certified copy of an instrument of partnership) has this day been registered with me, the Income Tax Officer for in the province of under clause (14) of Section 2 of the Indian Income Tax Act, 1922. This certificate of registration has effect from the day of April 19 up the 31st day of March 19 .”

“(2) The certificate shall be signed and dated by the Income tax Officer who shall thereupon return to the applicant the instrument of partnership or the certified copy thereof, as the case may be, and shall retain the copy or duplicate copy thereof.”

We are unable to accept the contention of learned counsel. Section 26-A of the Act provides that :—

“(1) Application may be made to the Income-tax Officer on behalf of any firm, constituted under an instrument of partnership specifying the individual shares of the partners, for registration for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax.

“(2) The application shall be made by such person or persons and at such times and shall contain such particulars and shall be in such form, and be verified in such manner, as may be prescribed ; and it shall be dealt with by the Income-tax Officer in such manner as may be prescribed.”

Rule No. 2 under the notification already mentioned prescribes that such application shall ordinarily be made before the income of the firm is assessed. The words in Section 26-A “for the purposes of this Act and of any other enactment for the time being in force relating to income-tax or super-tax” would seem to indicate that the Income-tax Officer should not register a firm upon receipt of an application under that section if he had reasons to think that it is not a firm such as is recognised by the Act. That the Income-tax Officer has authority to refuse to register an instrument of partnership is further proved by the fact that under Section 30 there is a right of appeal against such refusal ; and if

registration has been wrongly allowed, the Commissioner has the power to set aside that order under Section 33.

In *Tara Chand Pohu Mal v. The Commissioner of Income-tax* (A.I.R. 1936 Lahore, page 836), the assessee had been assessed up to 1928-29 as a joint family, but during the 1929-30 proceedings a member of the family applied on the 17th May 1929 for the registration of the family as a firm alleged to have been constituted under an instrument of partnership, dated 4th January 1929. A separate claim was not put in to the effect that the Hindu undivided family had disrupted. The Income-tax Officer registered the firm without holding any inquiry as to whether the family had actually effected a partition: but at a subsequent assessment the Income-tax Officer found that the status of the assessee was, in fact, that of a joint Hindu family. It was held by a Bench of the Lahore High Court that it was open to the Income-tax Officer to go into the question whether the family was joint or not, as it is an issue of fact, and that a wrong decision in the previous year by the Income-tax Officer could be corrected in a subsequent year.

Section 26-A comes after Section 25-A, and Section 26, and we think that it is open to the Income-tax Officer to suspend orders on an application already presented under Section 26-A by members of a Hindu family until the assessment proceedings are held. If at the time of making the assessment a claim is made under Section 25-A, it is the duty of the Income-tax Officer to decide whether there has been a separation of members and a partition of the property within the meaning of sub-section (1) of that section. If it is found that there has been such separation and partition, an order will be passed to that effect, and if it appears that a firm has been constituted by the separated units which have come into existence, the Income-tax Officer will proceed under Section 26 and will then register the firm upon an application under Section 26-A. In the present case no claim was made under Section 25-A. Nor could such a claim legally be made in view of the fact that there had been a partition of a portion only of the joint property and the status of the family remained undivided. Therefore, under Sub-section (3) of Section 25-A the family will be deemed, for the purposes of the Act, to continue to be a Hindu undivided family and will be assessed as a single unit and for the constitution of a firm there must be more than one unit. The application for registration under Section 26-A was rightly disallowed.

Our answer to the question formulated by the learned Commissioner is in the negative. We direct that a copy of our judgment under the seal of the Court and the signature of the Registrar be sent to the Commissioner. The Department is entitled to the costs of this reference. The hearing of the case has lasted for more than a day. The counsel for the Department will file his certificate within six weeks.

[IN THE LAMORE HIGH COURT]

PUNJAB CO-OPERATIVE BANK LTD.

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON and DIN MOHAMAD, JJ.

February 3, 1938.

BANKING COMPANY—PROFITS DERIVED FROM SALE OF SHARES AND SECURITIES—WHETHER CAPITAL OR INCOME—ASSESSABILITY—INTEREST RECEIVED BY VENDOR OF SECURITIES, WHETHER ASSESSABLE—INDIAN INCOME TAX ACT (XI OF 1922)

The question whether the amount realised by the sale of securities and shares in excess of their cost price forms an accretion to capital or is taxable as income depends on the facts of each case. In every case it has to be determined on its own facts whether the investment was a part of the ordinary business of the investor or otherwise, and the finding of the income tax authorities is conclusive unless it is found that it is based on no material.

Interest received by a vendee of securities from the vendor on the de die in diem basis is taxable in his hands, even though the entire interest received by the vendee from the Government would be taxable in the vendee's hands.

In the accounting year 1935, the assessee, a Bank, made a profit of Rs. 1,37,422 by selling securities and Rs. 5,166 by selling shares. The Bank claimed that it did not deal in shares and securities but was treating its investments in shares and securities as a reserve for emergencies and had to effect a sale of shares and securities in 1935 as they had to meet a heavy withdrawal of deposits and to deposit Rs. 2 lakhs odd with the Reserve Bank. From the fact that the articles of association of the bank authorised dealing in shares and securities, that the bank continued to sell shares

and securities at a profit in 1935, 1936, 1937 and other circumstances the income-tax authorities held that the profits in question were income derived from business and assessable to income-tax :

Held that in view of the balance sheets of the assessee, the fact that the assessee held securities worth more than 80 lacs as part of its circulating capital, that the securities sold were not ear-marked, and in view of the other circumstances, the finding of the income-tax authorities could not be said to be based on no materials, and the income was therefore assessable. The fact that the profits had not been utilised in the revenue account but carried to the reserve capital en bloc was not inconsistent with the finding that the profits were trading profits.

Cases referred to—

CALIFORNIAN COPPER SYNDICATE LTD. *v.* HARRIS [1904] (5 Tax. Cas. 159; 6 F. 894).

AMRITSAR PRODUCE EXCHANGE LTD. *IN RE* [1937] (I.L.R. 18 Lah. 706; 5 I.T.R. 307; A.I.R. 1938 Lah. 44).

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. [1932] (I.L.R. 59 Cal. 1343; 6 I.T.C. 178; 136 I.C. 742; 59 I.A. 206; A.I.R. 1932 P.C. 138).

HAVELI SHAH SARDARI LAL *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1936] (4 I.T.R. 297; A.I.R. 1937 Lah. 435).

HIBANAND JAIRAM SINGH *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1935] (3 I.T.R. 309; 8 I.T.C. 395).

PUNJAB NATIONAL BANK LTD. *v.* EMPEROR [1926] (I.L.R. 7 Lah. 227; A.I.R. 1926 Lah. 373; 96 I.C. 380; 2 I.T.C. 184).

REERS ROTURBO DEVELOPMENT SYNDICATE *v.* COMMISSIONERS OF INLAND REV. [1928] (1928 A.C. 132; 13 Tax Cas. 366).

ROYAL INSURANCE CO. LTD. *v.* STEPHEN [1928] (14 Tax Cas. 22; 44 T.L.R. 630).

SCOTTISH INVESTMENT TRUST CO. *v.* FORBES [1893] (31 Sc L.R. 219; 3 Tax Cas. 231).

TATA INDUSTRIAL BANK LTD., *IN RE* [1922] (I.L.R. 46 Bom. 567; 66 I.C. 979; 1 I.T.C. 152).

WESTMINSTER BANK LTD. *v.* OSLER [1933] (17 Tax. Cas. 381; 1 I.T.R. 65; 1933 A.C. 139; 102 L.J.K.B. 110; 148 L.T. 41; 49 T.L.R. 43 on appeal from 1932, 1 K.B. 668).

Case referred under Section 66 (2) of the Income-tax Act, by K. C. Basak, Esquire, Commissioner of Income-tax, Punjab, North West Frontier and Delhi Provinces on the 13th November 1937, for orders of the High Court.

Civil Reference No. 31 of 1937.

In the matter of the assessment of the Punjab Co-operative Bank Limited, Amritsar, for the year 1936-37.

STATEMENT OF CASE.

“Statement of Case under Section 66 (2) of the Indian Income tax Act arising out of the assessment of the Punjab Co-operative Bank, Limited, Amritsar, made under Section 23 (3) for the year 1936-37.

Facts of the Case.—The assessee is a joint stock company carrying on banking business. The accounting period of the assessee is the Calendar year. In the accounting period 1935 the assessee made a profit of Rs. 1,37,422 by selling securities and Rs. 5,166 by selling shares. The profits were not passed through the Profit and Loss account but were taken straight to the Balance Sheet. The Balance Sheets and Profit and Loss Accounts as on 30th June, 1935, and 31st December, 1935, are Exhibits A 1 and A 2. In the assessment order (Exhibit B) the Income Tax Officer taxed these two profits totalling Rs. 1,42,588. In its letter, dated 18th August, 1936, (Exhibit C) the Bank contended before the Income-tax Officer that the Bank was treating the investments in shares and securities as a reserve for emergencies and had resorted to their sale in the accounting period 1935 as they had to meet heavy withdrawals of deposits and to deposit in cash about Rs. 2,66,000 with the Reserve Bank. I may mention here that the Punjab Co-operative Bank, Amritsar, is one of the banks named in the second schedule of the Reserve Bank of India Act, 1934 (II of 1934) and according to Section 42 (1) of that Act every bank included in the second schedule is required to maintain a cash reserve with the Reserve Bank of India. The Bank claimed that it did not deal in shares and securities and therefore the profit made by the sale of shares and securities was not taxable. The Income-Tax Officer did not go into the question as to whether the Bank was dealing in shares and securities or not, but held that the income was taxable on the footing that when a person was dealing not in goods but in money and was taking money from his customers, and had to hold that money as a part of his business, and did so in the ordinary course of business in the form which was most profitable, having in mind the security and the requisite degree of liquidity, all his dealings in that money lay in revenue account with this difference that investments were not stock-in-trade to be valued as stock, but were only brought in when there was realization in some form.

2. While reconciling the interest on securities as per certificates under Section 18 (9) with the interest on securities as per accounts kept by the assessee, the Income-tax Officer discovered a difference of Rs. 2,764 due to interest of Rs. 3,075 received from vendee on *de die in diem* basis less interest amounting to Rs. 311 paid to vendor. The assessee claimed before the Income-tax Officer that the interest received from the vendee on *de die in diem* basis and interest paid to vendor should both be excluded because the entire interest received by the vendee from Government would suffer taxation in the hands of the vendee. The Income tax Officer, however, held that in view of the fact that Rs. 3,075 and Rs. 311 were profit and loss respectively in sale, none of these items would be excluded and he accordingly taxed the net amount of Rs. 2,764.

3. On these two points the assessee went up on appeal but the Assistant Commissioner decided against the assessee on both the points more or less on the same grounds as the Income-tax Officer. The appellate order is Exhibit D.

4. In the course of the hearing before me I had an opportunity of going through the accounts of the assessee. I give below a comparative table of the deposits, investments and the total reserve since 1932 as on the 31st of December of each year:—

Accounting year.	Assessment year.	Deposits in thousands. Rs.	Investments in thousands. Rs.	Total Reserve in thousands. Rs.
1932	1933-34	11,543	4,584	997
1933	1934-35	12,861	4,931	1,041
1934	1935-36	11,882	5,088	1,043
1935	1936-37	11,310	3,859	1,234

5. From the securities book of the assessee I have found that up to 1933 there was no sale of securities. The first sale of securities took place on 30th November, 1934, and on that date securities of the face value of one lakh purchased in 1926 at 77½ per cent to 77 and 9/16 per cent. were sold at 94 per cent. On 7th December, 1934, securities of the face value of Rs. 25,000 purchased in 1926 at 78 and 7/8 per cent were sold at 95 per cent; securities of the face value of Rs. 25,000 purchased in 1927 at 79 per cent were sold at 95 per cent. and securities of the face value of Rs. 25,000 purchased in 1927 at 79 and 5/16 per cent were sold at 95 per cent. On 22nd December, 1934, securities of the face value of one

lakh purchased in 1929 at 96½ per cent. were sold at 108 and 5-16 per cent. Similarly there were sales at profit in 1935 and these have been taken into account in the assessment for 1936-37. In 1936 the assessee continued to sell securities at profit and is still doing the same in 1937. The Company has not got any similar book for shares, but Mr. Rattan Lal Chowla, the Advocate for the assessee, and Mr. Aiyar, the assessee's Auditor have admitted before me that similar transactions are going on in shares as well.

6. Article 81 (i) of the Company's Articles of Association authorizes the Directors to invest the funds of the Company in such securities or investments as they may think advisable and from time to time vary them. Article 99 of the Company's Articles of Association empowers the manager at the head office and such Branch Managers as may be selected by the Board, to invest money belonging to the Company in Government Promissory notes, Railway Shares or other securities, and to sell, assign, transfer, mortgage or otherwise dispose of them.

7. **Questions referred.**—Being dissatisfied with the appellate order, the assessee has now come up with an application under Section 66 (2) (Exhibit E) and has asked me to refer the two points in paras 1 and 2 above to the Hon'ble High Court. So far as the first point is concerned, the assessee has not formulated any question in the application under Section 66 (2) but has merely given his arguments. So far as the second point is concerned, the assessee has formulated his question by taking into account only the interest received by him without referring to the interest paid by him which has been allowed as a deduction by the Income-tax Officer. In my opinion the following two questions arise out of the assessment for 1936-37, and I refer them for the decision of the Hon'ble High Court:—

(1) Whether in the circumstances of the case the amount of Rs. 1,42,588 realized by the assessee on the sale of securities and shares over their cost price is taxable? and

(2) Whether under the circumstances of the case the net interest amounting to Rs. 2,764 received from vendees of securities *on de die in diem* basis is taxable?

8. **Opinion of the Commissioner.**—(Question 1). The facts and contention in this case are exactly similar to those in the case of the *Amritsar Produce Exchange, Limited*, which was decided by their Lordships on 8th February 1937 (V Income-tax Reports 307). I asked the assessee to distinguish his case from that of the *Amritsar Produce Exchange, Limited*, and the assessee

submitted a long note written by his Auditor, dated 12th June 1937 (Exhibit F). In my opinion the assessee has completely failed to bring out any distinction. From para 8 of the Auditor's statement (Exhibit F) it is clear that the deposits that were invested in the shape of shares and securities represented the moneys received by the assessee from his clients in the ordinary course of business. The assessee's contention that he had to sell the securities in order to meet heavy withdrawal of deposits and to make the compulsory deposit with the Reserve Bank of India cannot be accepted because from the table given in para 4 above it will appear that although the deposits diminished from Rs. 12,361 thousand in 1933 to Rs. 11,882 thousand in 1934 the investments increased from Rs. 4,931 thousand in 1933 to Rs. 5,088 thousand in 1934. On the other hand it will appear from the same table that the total reserves rose from Rs. 1,043 thousand in 1934 to Rs. 1,234 thousand in 1935, *i.e.*, an increase of Rs. 191 thousand. The profits made by selling shares and securities in 1935 amount to Rs. 143 thousand roughly. It is, therefore, quite clear that the profits realized by selling shares and securities were utilized in increasing the reserves. From the sale prices and cost prices given in para 4 above, it is apparent that the assessee is selling the shares and securities in order to take full advantage of the high prices prevailing now and with the definite object of making huge profits. The assessee began selling shares and securities towards the end of 1934 and has continued doing the same at profit in 1935, 1936 and 1937. From para 6 above it will appear that the Company's Articles of Association authorise dealings in shares and securities. From these circumstances, I submit, only one inference can be drawn, and that is that the assessee has been carrying on business in shares and securities since the closing months of 1934 and the profits which arose in 1935 from the sale of shares and securities, arose from that business. No doubt the Income-tax Officer and the Assistant Commissioner did not examine the case from this point of view. As from all the facts placed before me by the assessee at the time of hearing of the application under Section 66 (2) I could come to a definite conclusion, I did not consider it worthwhile sending the case back to the Income-tax Officer or the Assistant Commissioner.

9. Another aspect of the case is as follows :—

Even if it be held that the assessee had to sell his shares and securities in order to meet heavy withdrawals of deposits, I submit

that the purchase and sale of shares and securities are so much linked with deposits and withdrawals of clients that with the existing Articles of Association the purchase and sale of shares and securities are as much part of the assessee's business as receiving deposits from clients and paying them off are, and therefore, the profits which arise from the former transactions are as much business profits as the profits arising from the latter transactions are. This is the view which the Income-tax Officer and the Assistant Commissioner took in rejecting the contentions of the assessee. In the statement of the Auditor (Exhibit F) reference has been made to the decision in *Commissioners of Inland Revenue v. Scottish Automobile and General Insurance Co., Ltd.* (X A. T. C. 411) but under exactly similar circumstances it has been held in the case of *Northern Assurance Co.* (II T. C. 571) that where the gain is made by the Company by realizing any investment at a larger price than was paid for it, the difference is to be reckoned among the profits and gains of the Company. The observations of ROWLATT, J., in *Westminster Bank Ltd. v. Osler* (XVII T. C. 381) also support my view.

10. *Question (2).*—If it is held that dealing in shares and securities is part of the assessee's business, then I submit that whatever money he realizes by selling the securities over their cost price is his business profit, and since in this instance there was a net receipt of Rs. 2,764 as interest on *de die in diem* basis it is clearly part of the business profit. The fact that the full interest on securities will be taxed in the hands of the vendee does not help the assessee at all, because the theory of double taxation does not apply in all cases. What is capital expenditure in the hand of A may be revenue receipt in the hand of B, and, therefore, while the expenditure cannot be allowed in the assessment of A, the receipt will be taxed in the hand of B.

11. For the reasons stated above, I respectfully submit that both the questions should be answered in the affirmative."

Mehr Chand Mahajan and Ratan Lal Chawla for the Assessee.
J. N. Aggarwal and S. M. Sikri for the Commissioner.

JUDGMENT.

SIR JAMES ADDISON.—The facts involved in this reference are fully set out in the statement of the case drawn up by the Commissioner of Income-tax under Section 65 (2) of the Income Tax Act and need not be recapitulated. The questions propounded by the Commissioner are :—

"(1) Whether in the circumstances of the case the amount of Rs. 1,42,588 realised by the assessee on the sale of securities and shares over their cost price is taxable? and -

(2) Whether under the circumstances of the case the net interest amounting to Rs. 2,764 received from vendees of securities on *de die in diem* basis is taxable?"

We may at the outset point out to the Commissioner the desirability of framing questions on a more precise and definite basis so that the issues of law referred to this Court may not admit of any ambiguity. The words "in the circumstances of this case" inserted in both the questions reproduced above leave the matter vague and indefinite. The facts are to be determined finally by the Income-tax authorities and the findings of fact arrived at by them are not liable to be disturbed by this Court. By using the words "in the circumstances of the case" the duty is, so to say, cast upon this Court to search out the circumstances on which the questions are founded and this is not the right way of dealing with the matter.

It is common ground that the assessee is a banking concern and that the profits in question accrued from the sale of securities and shares. The only question that falls to be judged, therefore, is whether these profits form part of the capital or the revenue account of the assessee. If they are in the nature of capital they are exempt, but if on the other hand, they are in the nature of revenue, they are taxable.

The Income-tax Officer while dealing with those profits observed:—

"Apart from bringing in any such considerations whether the Bank is dealing in securities or not, the income is taxable on the footing that when a person is dealing not in goods, but in money and is taking money as a part of his business, and does so in the ordinary business course in the form which is most profitable having in mind the security and the requisite degree of liquidity, then all his dealings in that money lie in revenue account with this difference that investments are not stock-in-trade and to be valued as stock, but only brought in when there is realisation in some form. I therefore hold that the profit is taxable".

On appeal the Assistant Commissioner also adopted the same view and upheld the decision of the Income-tax Officer. While disposing of the assessee's application under Section 66 (2), the Commissioner has stated that although the profits realised from

the sale of securities and shares were utilised in increasing the reserve fund, the only inference possible is that the assessee had been dealing in securities and shares as part of his business since 1934. The Commissioner, however, did not reject the conclusions arrived at by the Income-tax Officer and the Assistant Commissioner and considered that that was also a permissible way of looking at the matter.

The assessee contends that the opinion of the Commissioner as well as that of his subordinate officers is wrong and that inasmuch as the profits have admittedly gone to swell the reserve fund, they cannot be taxed. In support of his contention he has relied on *Westminster Bank Ltd. v. Osler*, *Punjab National Bank Ltd., v. Emperor*, *Amritsar Produce Exchange Ltd., In re.*, *Hiranand Jai Ram Singh v. Commissioner of Income-tax, Punjab*, and *Vanden Berghs Ltd. v. Clark*.

In *Westminster Bank v. Osler*, the assessee was an insurance company and like most insurance companies it had a reserve fund. The company sold a small part of the Government securities in which that reserve fund was invested, and invested the proceeds in other Government Securities of a different denomination, making a substantial profit. The question arose, whether the profit so made was a profit of the company's business. The General Commissioners held that it was not a trading profit. On appeal, the LORD PRESIDENT remarked that the question whether a person is or is not engaged in a trade is not a question of law but a question of fact and that the finding is only open for consideration if it was possible to say that there was no evidence before the Commissioners upon which they could reasonably arrive at their conclusion. In this connection his Lordship did not attach any importance to the fact that under the Articles of Association there was a power to invest the funds of the company in certain classes of securities and also to vary the investments of the company and observed: "It does not necessarily follow from the circumstance that the company sees fit to sell a block of its Government securities, whether the purpose be to get a better return or whether the purpose be to increase the reserve fund by taking profit from the realisation of a particular block, that therefore the company is trading in the purchase and sale of the securities forming its reserve fund". In a concurring judgment delivered by LORD SANDS, it was said "If the directors treat the profit from appreciation just as a trading profit, this may help the inference that the company was trading". On the finding that the assessee company was not

carrying on the business of an investment company, the appeal was disallowed.

In *Punjab National Bank v. Emperor* the assessee, a banking concern, claimed deduction on account of depreciation in the value of Government securities held by it, and it was held that the deduction claimed was not permissible under the Act as the securities are permanent investments of part of the fixed capital so retained as an emergency reserve and not part of the stock-in-trade.

In *Amritsar Produce Exchange Ltd., In re*, this Court considered the true implications of *Punjab National Bank v. Emperor* and remarked that it was not possible to lay down a rule of general application that in every case an investment in securities should be treated as fixed capital. It was however observed that if it could be found that an investment had been made for the purpose of permanently excluding a certain sum from the floating capital of a concern, it might be permissible to hold that that sum had no concern with the stock-in-trade. It is upon this observation that the assessee relies in connection with this case.

In *Hiranand Jairam Singh v. Commissioner of Income-tax, Punjab*, where the assessee who were general produce dealers trading in salt had on the abolition of the system of deferred payment for salt sold the Government securities deposited by them with the Commissioner of Salt, it was held that the loss incurred by the sale was a capital loss and not one sustained in business.

In *Van Den Berghs Ltd., v. Clark* [1935 I.T.R. Eng. Cas. 17 at p. 26] LORD MACMILLAN drew a distinction between fixed and circulating capital in the following terms:

"Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital is not involved directly in the process and remains unaffected by it."

The assessee has further relied on *Commissioner of Income-tax, Bengal v. Shaw Wallace & Co. Ltd.*, and urged that in view of the definition of income as given by their Lordships of the Privy Council, such casual and irregular monetary return in the shape of profits on the sale of securities as is involved in this case cannot be treated as assessable income under the Act.

On behalf of the Commissioner, reliance has been placed on *Tata Industrial Bank Ltd., In re, Scottish Investment Trust Co., v. Forbes, Californian Copper Syndicate v. Harris, Rees Roturbo Development Syndicate v. Commissioners of Inland Revenue*,

Royal Insurance Co. Ltd. v. Stephen and Westminster Bank Ltd., v. Osler.

In *Tata Industrial Bank Ltd., In re*, the assessee, a banking concern claimed to deduct from the taxable profits a certain sum said to be the amount of depreciation on war bonds and securities belonging to it and its claim was rejected.

In *Scottish Investment Trust Co. v. Forbes* it was held that if an Investment Trust Company takes powers in its Memorandum of Association to vary its investments and generally to sell or exchange any of its investments, the net gain by realising investments at larger prices than were paid for them constitutes profits chargeable with income-tax. It was remarked by the LORD PRESIDENT who delivered the judgment that the power of varying the investments and turning them to account "took their place among what are the essential features of the assessee's business and were the appointed means of the company's gains."

In *Californian Copper Syndicate v. Harris* a company formed for the purpose, *inter alia*, of acquiring and reselling mining property, after acquiring and working various property, resold the whole to a second company, receiving payment in fully paid shares of the latter company. It was held that the difference between the purchase price and the value of the shares for which the property was exchanged is a profit assessable to income-tax. While differentiating between cases where enhanced values on realisation of investments are assessable and those where they are not, the Lord Justice Clerk observed: "What is the line which separates the two classes of cases may be difficult to define and each case must be considered according to its facts; the question to be determined being is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?"

In *Rees Roturbo Development Syndicate v. Commissioners of Inland Revenue* SCRUTTON, L.J., at pages 390-391 of the report observed that the question whether a trade is being carried on is a question of degree and fact and it was impossible to say that there was no evidence on which the Commissioners could find that the transactions were part of, incidental to and arose out of the appellant's trade or business.

In *Royal Insurance Co., Ltd. v. Stephen* it was held that the surrender of the old stocks enabled the result of the company's holding of those investments to be definitely ascertained and was

equivalent to a realisation. In this case the company admitted that any profit made on the realisation of an investment was part of its profits for income-tax purposes.

In *Westminster Bank Ltd. v. Osler* it was held that the conversion of war bonds was equivalent to the realisation of investments. Here also it was admitted by the assessee that profits on realisation of investments should be included in their profits for income tax purposes.

On a review of the authorities cited at the Bar we are again led to the same conclusion as was arrived at in *Amritsar Produce Exchange Co., Ltd., In re*, that in every case that arises, it is to be determined on its own facts whether the investment was a part of the ordinary business of the investor or otherwise, and in this matter, the finding of fact arrived at by the income-tax authorities is conclusive unless it is found that that finding was based on no material. Ongoing through the two balance-sheets put in by the assessee as also the Auditor's note (Exhibit F) and taking into consideration the fact that the assessee held securities worth more than 30 lacs as part of its circulating capital and that the securities which were sold were not earmarked, it is difficult to say that the opinion of the income-tax authorities is based on no material. It is true that the profits have not been utilised in the revenue account and that they have been carried to the reserve capital *en bloc* but that circumstance is quite consistent with the finding of the income-tax authorities that they were trading profits. The fact that no securities were sold during the first six years of their purchase was also present to their minds and if they still did not draw a conclusion favourable to the assessee, they were at liberty to do so. In this view of the case the income derived by the assessee as remarked in *Amritsar Produce Exchange Ltd., In re*, can on no account be deemed to be casual. We consider therefore that the answer to the first question should be in the affirmative and we answer it accordingly.

The assessee admits that the answer to the second question depends on the decision given on the first question and we answer that question too in the affirmative. Even otherwise there is against the assessee a clear authority of this Court reported as *Haveli Shah Sardari Lal v. Commissioner of Income-tax, Punjab*.

Reference answered.

[IN THE NAGPUR HIGH COURT].
 COMMISSIONER OF INCOME TAX, C.P. & U.P.

v.
 SETH BIRDICHAND

GRILLE, J.

April 7, 1938.

BAD DEBT—QUESTION WHEN DEBT BECAME BAD—QUESTION OF FACT—FINALITY OF DECISION OF INCOME TAX AUTHORITIES—INCOMPETENCY OF REFERENCE—INDIAN INCOME TAX ACT (XI OF 1922), SEC. 66 (3).

The question when a debt became bad is a question of fact to be determined by the income tax department, and no reference therefore lies against a decision of the income tax authorities on the question when a particular debt became bad.

Cases referred to :

COMMISSIONER OF INCOME TAX, BOMBAY v. VALLABHDAS MURLIDHAR [1930] (I.L.R. 54 Bom. 480; A.I.R. 1930 Bom. 201; 4 I.T.C. 318).

COMMISSIONER OF INCOME TAX, C.P. and BEHAR v. SIR S. M. CHITNAVIS [1932] (28 N.L.R. 205; 137 I.C. 772; 59 I.A. 290).

PURAN MAL v. COMMISSIONER OF INCOME TAX, PUNJAB [1927] (2 I.T.C. 236).

GRILLE, J.—This is an application under Section 66 (3) of the Income-tax Act by the assessee whose application to the Commissioner of Income-tax has resulted in a refusal by the latter to state a case and refer it to this Court. The question at issue is whether the Income-tax Department has been correct in refusing to reduce an assessment on account of two items of bad debt claimed by the assessee. In one case the Income Tax Officer decided, and was upheld by his appellate authority, that the claim was premature, and in the other that the claim was too late. The Commissioner of Income Tax held that the decisions were supported by good reasons and that, as the questions were questions of fact, there was no case to refer to the High Court.

2. The questions which the Income-tax Commissioner was requested to refer ran as follows :

“1. (a) Was not the assessee justified in writing off the debt of R. S. Chainsukh when he knew that the debt was irrecoverable?

(b) Was he bound to wait till the actual order for discharge was passed when in the account year it had become clear that the balance of debt was irrecoverable?

(c) Is not the assessee the sole judge in deciding the question of irrecoverability of the debt?

"2 (a) Was not the assessee entitled under law to write off the debt of Dost Mohammad in the circumstances of the case, when he lost all hope of recovery?

(b) Though the decretal debt was alive, could it be said to be too late to claim a deduction?"

On the first point the assessee claimed his debt as a bad debt even before an order of discharge had been passed against the insolvent, and it is contended that, as the case was quite hopeless and a very small dividend had been declared, the assessee was justified in writing the debt off as a bad debt, even though no order of discharge had been passed, and in fact an order of discharge was passed shortly afterwards in the following year. It can hardly be said that the decision of the Income-tax authorities to consider the claim of a bad debt premature before the Insolvent had been discharged, is unreasonable. The other point related to a matter of a decree which the assessee had been attempting to execute. The decree was obtained in 1922, an application for execution was struck off as infructuous in 1932, and the bad debt was claimed in respect of the year 1934-35. Here the Income-tax authorities held that the debt should have been included in the accounts of 1932. The first amount is for Rs. 20,919-15-6 and the second for Rs. 2,207. In the second case the point taken is more arguable than in the first: but nevertheless it cannot be said—and this is the only ground on which there is any hope of the application being accepted—that the decision is arbitrary and perverse.

3. It has been established in the Courts in India that the Income-tax Department is to be the Judge when a bad debt is to be written off. In *Puran Mal v. Commissioner of Income-tax* (2 I.T.C. 236) MARTINEAU, J., stated:

"I am of opinion that the Income-tax Officer must be the judge of the question whether or not a debt became irrecoverable in the year in which the assessee wrote it off, and that the matter is not one which depends on the choice of the assessee".

In the same case RAOOF, J., stated:

"It lies upon the assessee to prove by evidence to the satisfaction of the Income-tax Officer that the debt became irrecoverable in the particular year in which the deduction is claimed.

In *Commissioner of Income Tax, Bombay Presidency v. Vallabhadras Murlidhar* (I.L.R. 54 Bom. 430) it was held that the question

when a bad debt should be written off was one of fact, to be decided with reference to the circumstances of each case, and that it was for the assessee to establish the facts by evidence. The opinion of the Judicial Commissioner's Court, Nagpur, was otherwise, and in *Commissioner of Income-tax v. Sir S. M. Chitnavis* (25 Nag. L.R. 35) it was held by a Full Bench that an assessee's option to write off debts as bad is absolute both as regards the amount to be written off and the choice of time at which to do so. It was also held that the Income-tax authorities could not override the assessee's option in this matter. This opinion was emphatically overruled by their Lordships of the Privy Council in *Commissioner of Income-tax, C. P. & Berar v. Sir S. M. Chitnavis* (28 Nag. L.R. 205). At page 212 their Lordships say :

"Whether a debt is a bad debt and if so, at what point of time it became a bad debt are questions which in their Lordships' view are questions of fact to be decided in the event of dispute by the appropriate tribunal, and not by the *ipse dixit* of any one else". Lest it should be imagined that the "appropriate tribunal" would include a High Court, I would refer to the concluding portion of the judgment at page 214 where their Lordships state that the answer to the reference which was made to the Judicial Commissioner should have run ;

"The assessee has no 'option' of declaring debts bad. Whether a debt is bad, and when it became bad, are questions of fact to be determined in case of dispute not by the assessee or by the exercise of any 'option' on his part but by the appropriate tribunal upon a consideration of all relevant and admissible evidence"

It is clear, then, that the question when a debt became bad is a question of fact to be determined by the Income-tax Department, and no reference against any such decision will lie. An attempt has been made by the learned counsel for the applicant to distinguish this very clear decision by the fact that the assessee's attitude was considered in the case of *S. M. Chitnavis* as recalcitrant. That appears to me to be entirely beside the point, and although he may have declined to prove his case by evidence, and their Lordships have held that the Income-tax authorities must consider relevant and admissible evidence, it has not been argued before me that any evidence whatever has been excluded.

4. Findings of fact as to what is a bad debt and when a debt became bad are matters which cannot be raised in a reference to this Court. An attempt has been made in the language used in

the points which the Commissioner of Income-tax was asked to refer to this Court to clothe these questions of fact in such a garb as to make them appear questions of law, which they are not. The result is that the application must fail and it is accordingly dismissed with costs. I fix pleader's fees at Rs. 40.

Application dismissed.

[IN THE LAHORE HIGH COURT.]

COMMISSIONER OF INCOME TAX, PUNJAB

v.

NAWAB SHAH NAWAZ KHAN.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

December 14, 1937.

APPEAL—ENHANCEMENT OF ASSESSMENT—ASSESSEE WHETHER ENTITLED TO WITHDRAW APPEAL TO PREVENT ENHANCEMENT—APPEAL FROM ASSESSMENT UNDER SECTION 34—ENHANCEMENT OF ASSESSMENT SO AS TO INCLUDE OTHER ITEMS WHICH HAD ESCAPED—LEGALITY—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 31, 34.

It is not open to an assessee who has preferred an appeal to withdraw the appeal so as to prevent the Assistant Commissioner from enhancing the assessment. The Income Tax Act is a special piece of legislation and so far as it goes it is self-contained.

But a notice issued under Section 34 of the Income Tax Act pertains to those items only which have escaped assessment and it is not permissible to the Assistant Commissioner in an appeal from an assessment made under Section 34, to add fresh items of income under different heads to the items already detected as having escaped, after the limitation prescribed by Section 34 has expired.

The general power of an Assistant Commissioner under Section 31 (3) (a) and (b) to enhance an assessment on appeal cannot be exercised so as to override the limitations imposed by Section 34.

An assessment was made on June 23, 1933, for the year 1933-34. On February 16, 1935, an additional assessment was made under Section 34 in respect of a sum of Rs. 8,675. The assessee appealed against this order and during the pendency of the appeal the Assistant Commissioner came to know that another item of Rs. 89,796 had also escaped assessment and issued a fresh notice in respect of it on 12th February 1936. The assessee in the meanwhile applied for withdrawing the appeal: Held, that it was not open to the

assessee to withdraw the appeal; but the Assistant Commissioner had no power to enhance the income assessable under Section 34 so as to include the sum of Rs. 88,796, or to make a direction under Section 31 (3) (b) so as to enable the Income Tax Officer to make a fresh assessment in relation to this sum.

Cases referred to :

GANESH DAS, *In re* [1927] (I.L.R. 8 Lah. 354 ; 100 I.C. 657 ; A.I.R. 1927 Lah. 248 ; 2 I.T.C. 316).

GANGA SAGAR v. EMPEROR [1929] (120 I.C. 435 ; 1930 A.L.J. 26 ; A.I.R. 1929 All. 919).

JAGARNATH THEERANI v. COMMISSIONER OF INCOME TAX, BIHAR & ORISSA (1925 Pat. 408 ; 4 Pat. 385 ; 86 I.C. 777 ; 6 P.L.T. 165).

NAWAL KISHORE KHARAITI LAL v. COMMISSIONER OF INCOME TAX, PUNJAB (1936 Lah. 897 ; 38 P.L.R. 1107 ; 1936 I.T.R. 237).

NORTH BRITISH & MERCANTILE INS. Co., [1937] (1937 I.T.R. 349 ; 41 C.W.N. 905 ; I.L.R. 1937, 2 Cal. 540).

R. v. INCOME TAX SPECIAL COMMISSIONERS ; ELMHIRST, *Ex parte* (105 L.J.K.B. 759 ; 1936, 1 K.B. 487 ; 154 L.T. 198 ; 79 S.J. 941 ; 52 T.L.R. 143).

STATEMENT OF CASE.

Case stated by the Commissioner of Income-tax, Punjab, under Section 66 (1) of the Indian Income Tax Act, in the matter of appeal pending against assessment of Nawab Shah Nawaz Khan, for 1933-34 under Section 34 of the Act.

2. It is sought to raise charge upon Money-lending Interest Income believed to have been received in the relevant "previous year", 1932-33.. There was on 23rd June, 1933, an assessment which included some Money-lending Interest, but not anything for the transaction now in consideration. There was thereafter on 16th February, 1935, an additional assessment under Section 34, which brought in further some alleged profits on dealings in Securities. That assessment is pending appeal ; and it has appeared in course thereof that Interest-Income amounting possibly to Rs. 90,000 and odd was not returned in either assessment. The question which I refer of my own motion, seeking the guidance of the Court in a substantial difficulty of procedure towards raising the charge that ought to have been raised, is—

"Can interest-income as described in the case be brought into charge : either by enhancement under Section 31 (3-a) of the Section 34 assessment which does not include any such Interest-income : or in fresh assessment to be directed under Section 31 (3-b) ?"

Statement of Facts.—It is unfortunately necessary to refer to many difficulties which are the result of slack and incompetent work; partly by employees of the Court of Wards and partly by the Income-tax Officer, whose excuse to me is that he relied upon the reliability of the former. I shall make no comment upon this.

4. From at least 1916-17, an assessment was made in the dubious style and status, "Mamdot Estate, Individual." It relates to an Estate which was in the Court of Wards, up to (it is said) 31st August 1934. The assessment failed to specify the beneficiaries and charge properly under Section 41 of the Act: but purported to take the whole income of the Estate-administration. So far as I can see, however, this brings in no present difficulty.

5. The (sole or principal) beneficiary up to 1928 was the last survivor of the junior line descending from Qutub Din Khan (the senior line being, it is said, "disinherited"). He died, and his widow (Begum Maharbano Ghulam Qutub-ud-Din Khan) eventually in 1934 made an agreement transferring the Estate to the representative of the senior line, namely the present assessee-appellant. The transfer-agreement required certain cash payments to the Begum, which are said to have been made in October, 1935. No other information as to the "persons" concerned has so far been obtainable; but this is I think enough.

6. The Court of Wards Account Code requires certain account books; and the following were kept and have been in evidence :—
Cash Book (and Bank Pass Book).

Register of Government Security Investments.

Register of Loans.

The latter comprises personal ledger accounts of the borrowers (only). Cash receipts and disbursements are entered; and interest computations are made from time to time, but generally only in relation to cash settlements.

The assessee's method of account has throughout been described as, and certainly purported throughout to be cash. The Interest returned purported to be totalled from the attributions of Cash receipts to Interest, in the Debtors' personal-ledger: (there being apparently no Interest Impersonal-ledger-folio in the books themselves).

7. Interest on Securities, from Bank Deposits, and from Lending has throughout been returned and assessed. The classifications have been extremely careless, and the two latter heads have usually been lumped together under "Other Sources." (The

present assessment puts the whole income under that head; although on the face of it, what was being done was to bring in an alleged Business profit). Sometimes however, e.g., 1928-29, they were lumped under "Business", and e.g., in 1932-33 the Money-lending was separated as "Business".

The Money-lending is in fact extensive enough to be held in fact to be Business. The grounds of appeal on the assessment in present issue (which as above comprises only an addition for alleged dealing in securities) includes no allegation of non-succession; and it appears that as in 7 I. T. C., the present proceedings rightly lie against the Nawab, as successor to the Money-lending from September, 1934.

The assessment in issue is one made on 16th February 1935 upon the Nawab, (see 6 I. T. C. 475) for 1933-34 on account 1932-33.

8. The official manager of the Court of Wards Estate during the material years was Khan Bahadur Abdul Majd Khan (now retired). He signed the original 1933-34 Return (and also the 1934-35 Return, which as below is likewise incomplete).

It includes under item 8, a sum of Rs. 5,805, being interest comprising three loan account attributions. (One of these was in account of Kanwar Jasjit Singh, against cash payment on 11th July, 1932. This borrower is concerned in the transaction now sought to be brought in; but it is noted that this is a separate loan and a separate account; and nothing in respect of this was included).

The Income-tax Officer purported to examine the books; but if he did so at all, did so most unsatisfactorily; and he only included this amount as it stood in his assessment, dated 23rd June, 1933, totalling Rs. 47,536.

9. The 1934-35 Return was filed on 9th May, 1934, and similarly included Rs. 5,943 in which are comprised sums of Rs. 542 and Rs. 472 in the name of Rani Parbati Devi (which will be reverted to below).

This 1934-35 assessment was delayed. Eventually notice under Section 23 (2) issued for 14th February, 1935, to the Nawab—the Income-tax Officer presumably knowing then that he had taken over the Estate. It seems that appearance was made by Mr. Sabir Hussain, who was and is the manager appointed by the Nawab. His express authority to act as attorney for the Nawab in Income-tax matters is not in evidence; but has not been denied in the existing grounds of appeal.

The accounts were examined on that day for the Income-tax Officer by an Inspector who noticed that there had been in both this *and the earlier year*, profits on sales of Securities. He thought—wrongly in my view—that these were chargeable profits. The Income-tax Officer took up this matter, and did so with unfortunate disregard of proper office practice. His covering "Order" (Diary) Sheet reads—

"Present, Return under Section 34 has also been filed. Notice under Section 23 (2) served. Accounts have been examined."

There is an acknowledgement slip for the Section 34 Notice; on which the Income-tax Officer wrote, "Served personally"; but neglected to get Sabir Hussain's signature. There is a Form of Return for 1933-34 in which Sabir Hussain has written the figure which the Income-tax Officer proposed to (and did) assess; and there is a Notice under Section 23 (2) duly acknowledged (which can only have been for 1933-34, though it does not specifically show the year).

10. There are two difficulties that arise from his carelessness in this regard :—

(a) In any further *assessment* stage, the Nawab may disclaim the authority of Sabir Hussain to be served on his behalf, or to make Return on his behalf. I am unable to compel him to show his hand in this matter, and can only say that there is no evidence either way, of authority or no authority.

This ground not having been taken in appeal, I do not think it could be taken in any later stage of *this appeal itself*, but it could in a fresh assessment.

(If it be taken, I do not think actual *delivery* of the Section 34 Notice to Sabir Hussain can be questioned. Apart from secondary evidence of the delivery, there is the Return: and although Case Law (to which I need not here give more specific references) has held that Criminal or Penal action can be defended by requiring proof-of-service as well, I do not think such objection could be taken against assessment upon Return; only possibly on the one ground common to both the Notice and Return, of no-authority).

(b) There is no evidence as to the actual content of the Section 34 Notice, which may possibly be thought to affect the action proposed now to be taken. There is no Office Copy, and the assessee is said not to have preserved his copy.

The form of Notice is not prescribed under the Rules, but it is actually provided by the Rule-making authority, in Form I. T.

90 (Copies will be laid before the Court). Its opening phrases indicate the Class of Income alleged by the assessing officer to have escaped; and question may possibly be argued as to the effect of there being no evidence of this Notice in issue having specifically embraced this present Loan-Interest.

In the first place (if the matter does arise), in my opinion the content of the explanatory and introductory entries in the Form does not affect the statutory provision about the additional assessment—if a Notice under Section 22 (2) is served accompanied by a Section 34 Notice, the additional assessment is at large and not restricted either by the extent of the Income-tax Officer's initial knowledge of what may have escaped or his description of it.

In the second place, if the entry was enough to comprise profits on dealings in Securities—which has not been challenged in appeal—it would be enough to comprise the profits of the business of Money-Lending.

(Your Lordships will not be asked at this stage to resolve possible contests of this kind; but the nature and probable line of answer to the difficulties is noted, in explanation of reasons for seeking to take one or other of the courses now in contemplation),

11. Appeal was filed in respect only of the Income Tax Officer's failure to isolate Interest-content of the Sale-profits, which was said to have been doubly assessed thereby.

While it was still pending, the 1935-36 assessment began. This notice was addressed to the Nawab; and his return was signed for him by Sabir Hussain. No money-lending Interest was returned. A new Officer handled this case now; and he looked into the books to see why this should be, and detected that there had been realisations in account Jasjit Singh, Parbati Devi, which were ascribed to principal: but that this account was (in his view) wholly attributable to Revenue, for reasons expanded below. He took Section 34 action for 1934-35; and Sabir Hussain admitted the sum in that regard, and it was assessed on 23rd November, 1935—Rs. 4,305. Now it was the terms of that account so treated, that has drawn the attention of the Assistant Commissioner, to the present matter, in this 1933-34, Section 34 appeal still then pending.

(It may be noted, though it has no positive relevance, that there was in 1933-34 account another transaction wholly identical in character with that now to be described: of which the Income was likewise not brought into either of those 1934-35 Returns; and which the Income-tax Officer failed to observe even

when he was looking through these accounts as above. This has irretrievably gone out of assessability. The amount is less than Rs. 4,000 and it is not of much importance).

12. Now the transaction that was discovered and is now sought to be brought in was this: On 14th January, 1928, the Estate loaned to Jasjit Singh and Madanjit Singh (of whom Parbati Devi is the widow) two lakhs, on mortgage of the village of Partapnagar. The deed fixed dates for instalment repayments, and their appropriation between Principal and Interest, biennially from July, 1930; but no such payments were made before 1933.

Under date 21st October, 1931, the head of the Wards Administration (Financial Commissioner), "sanctioned the sale of 604 acres of land in Partapnagar for a total sum of Rs. 2,41,600 at Rs. 400 per acre in favour of the Mamdot Estate." It is not in evidence why he was responsible in respect of the sale: but presumably he being concerned thus both with the sale and the purchase, the price fixed is likely to be fair value.

The transaction was, however, only carried through or at any rate accounted by the assessee, on 10th February, 1933; when the account entry runs—

	Rs.
Loaned ...	2,00,000
Interest at 9 per cent. from 16th January, 1928, to 10th February, 1933. ...	91,250
Village Partabnagar, purchased for ...	2,43,100 *.
Bond executed for (to be paid in eight quarterly instalments with interest at 9 per cent.) ...	48,150

The further account on that bond (taken to a new folio) shows only:—

	Cash repaid, attributed to	
	Principal Rs.	Interest Rs.
7th July, 1933	3,009	542
18th January, 1934	526	474
28th March, 1934	500	...
Total	4,035	1,016

* Difference from figure above is not explained.

The interest column total is what the assessee himself included in Interest, for the 1934-35 (account 1933-34) assessment. The "Principal" column is what the Income-tax Officer added under Section 34 for that year.

The amount now sought to be charged in 1933-34 (account 1932-33) assessment is the above Rs. 91,250: less the Rs. 4,035 actually (though in my view erroneously) assessed in the following year.

At this stage it would be improper to ask your Lordships to consider any contention about this quantum, equally with the matters in paragraph 10 above. I only record for explanatory reference why I think the above is the sum that is chargeable.

The series of 1932 decisions of the Privy Council establish:—

(a) Land thus taken over is an accountable receipt of money's worth and the purchase price in account is good evidence of actual worth.

(b) A renewal of liability by bond is not such.

(c) In the absence of appropriation by the deeds or in account, the primary presumption is of attribution to Interest.

I think in the present case (b) and (c) hang together, and show doubly that the whole accounted interest must be held to have been received within the money's worth (Cash) receipt in excess thereof.

13. In the appeal case, the Assistant Commissioner issued notice as to enhancement in the present regard (under Section 31 (3) proviso). The appellant then filed application to withdraw the appeal.

14. **Opinion of the Commissioner.**—As in the United Kingdom case of (Reference at present available is "Taxation": 11th January, 1936 (page 239), *ex parte L. K. Elmhirst* the attempt to withdraw cannot succeed in avoiding the issue. (This indeed seems to be an example of the kind of thing contemplated by the Judge therein).

15. The provisions for raising charge on what has not been included in an assessment are :

(i) Section 34 :—Empowering an Income-tax Officer to bring in what may have "*escaped assessment*". This is the only relevant provision for which any time-bar is specifically enacted (and it would have operated against this transaction on 31st March 1935).

(ii) Section 31 (3 a).—Empowering an Assistant Commissioner in disposing of an assessment-appeal, to "*enhance*".

(iii) Section 33—Empowering a Commissioner “subject to the provisions of the Act, to pass such orders as he thinks fit: provided that he shall not pass any order prejudicial to an assessee without hearing him, etc.”

I do not know of any Case-law as to what is or is not “enhancement” but there has been a good deal in respect of the cross-relation of (i) and (iii) above.

There is the group of cases ending with *Dey Brothers* (Rangoon 9th March, 1936), to the effect that if what an Income-tax Officer does is by way of revising his assessment, it is in excess of his powers and is not anything within Section 34.

There are the cases which I summarised in stating 8 I.T.C. 413 in which I opined that if what was sought to be brought in was some transaction that had, either deliberately or by error or inadvertence, not been brought in, that was to bring in something that had “escaped assessment”. Your Lordships delivered dissenting judgments; and the majority carried the *dicta* further than I had contended for, practically to the effect that any increase of quantum must be a bringing in of something that had escaped.

Then there came the case of *Nawal Kishore* (Lahore, 16th March 1936), where out of the Section 34 time-bar (but in continuous course of proceedings put before me by the assessee himself), I did what the *Lu Nyo* group of decisions said an Income-tax Officer could not do within Section 34. I accepted that the Section 34 limitation applied to Section 33, if what was sought to be done by way of Section 33 was something that did lie in the scope of Section 34; but I had not anticipated so wide a scope for it as the majority gave in *Madan Mohan Lal*. I am not sure how far my express differentiation between what I did and the handling of hitherto unevenced transactions, was pressed before your Lordships: but the conclusion in the judgment apparently was that it was actually something that was within Section 34 and was barred therefore. It is these two judgments together that leave me uncertain what view Your Lordships will take about “enhancement.”

16. I was informed that your Lordships were prepared to certify appeal from your *Nawal Kishore* decision, if that were applied for. I did not apply as it is desired to make as little use of the “prejudicial” powers of the Commissioner as possible, and it seemed best to defer any possible contest about those until there has either been clarifying legislation, or a case of major financial importance arises.

Now the present difficulty turns upon whether any like limitation will be put upon the appellate enhancement powers. To a considerable extent, the arguments that have been used about the Section 33 powers which might well be thought to be in turns no less extensive than those in Section 32 would apply. The administrative position necessitates my resisting any like cutting down of the appellate powers; unless I am assured that the alternative recourse back to reassessment can be made use of. As this is an adjectival matter on which a wrong step will be irremediable, the issue is being put under Section 66 (1).

17. As indicated by the question, two alternatives appear to be practicable, but they are mutually exclusive.

The recourse to fresh assessment, to be directed under Section 31 (3b), presents some special difficulties in the present case, due to the errors of the Income-tax Officer; and I would wish to avoid being forced to it. But as a possible *pis aller*, it is contended for and as to this in my opinion—

(a) if any assessment, whether under Section 34 or under Section 22 substantively, be reopened duly in appeal, there is no legal bar to complete assessment of all the chargeable income that may be ascertained in such re-assessment.

(b) if that be not agreed to, at least on the re-opening of a Section 34 assessment, such reopened assessment must extend as far as the scope of the original Section 34 Notice (which in my opinion as in paragraph 10 above is the same as (a) above).

18. I would prefer the recourse to "enhancement" under Section 31 (3-a), but the difficulties possibly arising seem to be—

(a) does the power of "enhancement" extend to bringing in a hitherto unconsidered transaction?

(b) if it does, will Your Lordships apply the Section 34 time bar to it, in view of the fact that obviously it is something that would be within Section 34, and that bar has been extended to Section 33.

19. In so far as intention of the legislature can be in judicial consideration, the following is all I can ascertain of the history of these provisions.

The 1886 Act empowered the Collector to deal with applications for reduction of assessments made by him, etc.; and his assessment powers under its Section 14 seem to be unlimited. The 1918 Act practically brought in our present provisions (its Sections 22, 23 and 25); but I can trace no preliminary discussions. There are some comments by the 1921 Committee (page clxxiii

of *Sundaram's Commentary*, 4th Edition). There was later a proposal to extend the Section 34 period : (page clxxxv, *loc cit*); but it was not adopted (the circumstances not appearing in the cited reference).

20. Nor do I think the United Kingdom handling of the discovery of error provision can be usefully referred to. But the case cited in paragraph 14 above (and *19 T. C. 692* as to continuance of jurisdiction for additional assessment) may have a general and comparative bearing.

It seems to me to be a matter turning upon principles of restrictive interpretation. On the one hand anything which tends to defeat due charge and thereby lay heavier burden upon more conscientious subjects of the Crown is to be resisted, and the party claiming the bar must put himself clearly in the four corners of it. On the other hand, when the Legislature does think it necessary to protect the party, he ought to have the full benefit of that protection. Which of these conflicting principles is paramount here?

I do not see how the issue of what is fair and equitable can be kept out of this consideration : (though of course there are isolated dicta that can be cited both for and against such consideration). There obviously must be some limit to the time for which a man must be prepared to deal with account of his income; and in the conditions of India I should personally be reluctant to exercise a power, even if it were given, to start up such inquiry more than two years after the end of the account. But when the account is in live issue, and the evidence necessarily kept in hand, it seems to me that there is absolutely no justification for bringing in any limitation that is not clearly imposed. Accordingly the *ad hoc* exercise of Section 33 powers for Section 34 purpose might well be held barred thereby; but I do not see either commonsense justification (in so far as machinery provisions are to be interpreted to make the Act effective as far as possible, not nullify it as far as possible), or specific verbal justification in the Act, for imposing such a bar upon the appellate authority.

Nor do I see how the scope of the appellate power, to "enhance" can be cut down to mean only mere revision of existing items. The term can be whittled down or extended, just as the rulings on Section 34 have ranged over the area marked by the two extremes in Your Lordships' dissentient judgments on *Madan Mohan Lal*. It can be given an all-embracing meaning, or a narrow meaning. In my opinion, the intention, and the proper

interpretation, is to give it its widest meaning, to embrace any increase of quantum assessed.

21. Hence in my opinion :—

I. The interest-income described can be brought into charge by the Assistant Commissioner under Section 31 (3-a).

(and if your Lordships accept this, it will be unnecessary to give answer to the following) : and

II. It can be brought into charge by the Income-tax Officer if he be directed to make a fresh assessment under Section 31 (3-b).

S. M. Sikri for *J. N. Aggarwal*, for the Commissioner.

Malik Barkat Ali, for the Respondent.

JUDGMENT.

This is a case stated by the Commissioner of Income Tax, under Section 66 (1) of the Income-tax Act. The question propounded by him reads as follows :—

“Can Interest-income as described in the case be brought into charge either by enhancement under Section 31 (3) (a) of the Section 34 assessment which does not include any such Interest-income : or in fresh assessment to be directed under Section 31 (3-b) ?”

To this another question dealing with the withdrawal of the appeal before the Assistant Commissioner was added by this Court at the request of the assessee on which a supplementary statement of the case has been submitted by the Commissioner.

The facts are these : On the 23rd June, 1933 an assessment was made on the Mamdot Estate for the year 1933-34, the accounting year being 1932-33. On the 16th February, 1935, an additional assessment was made under Section 34 of the Income-tax Act in respect of a sum of Rs. 8,675½ which the assessee was said to have earned from interest on securities. The assessee appealed against this order to the Assistant Commissioner of Income-tax, and while that appeal was pending, the Assistant Commissioner of Income-tax came to know that another item of income derived by the assessee from a certain mortgage transaction had also escaped assessment in respect of which a fresh notice was issued verbally on the 10th and in writing on the 12th February, 1936. On the 10th February, when the Assistant Commissioner of Income-tax gave vent to his thoughts that he was considering this additional item for assessment, the attorney for the assessee verbally asked for the withdrawal of the appeal and later implemented his verbal request by presenting an application in writing. On

the 12th February, 1936, however, the Assistant Commissioner, holding that the appeal could not be legally withdrawn, ordered that the assessee's appeal would remain pending till it was decided whether he could enhance the assessable income by a sum of Rs. 88,796. It is in this connection that the reference has been made.

Three questions arise for decision :—

(1) Whether an appeal presented under Section 30 of the Income Tax Act can be withdrawn ; if so, whether the notice for enhancement could be legally given after the appeal had been withdrawn ?

(2) Is the Assistant Commissioner legally competent to add a new item of income, after the expiry of the limitation prescribed in Section 34, when an appeal against an assessment made under that section is pending before him ?

(3) Is the Assistant Commissioner competent to set aside the assessment made under Section 34 and direct the Income-tax Officer to make a fresh assessment including a fresh item of income after the period of limitation prescribed in Section 34 has expired ?

Questions Nos. 2 and 3 are the same as propounded by the Commissioner, though expressed in different words.

In our view all these questions must be answered in the negative.

We take up question No. 1 first. The Income-tax Act is a special piece of legislation dealing with a special subject and so far as it goes it is self-contained. It will be seen that whereas the powers of a Civil Court are vested in the Income-tax authorities by virtue of Section 37 of the Income-tax Act, they have been restricted to the particular matters dealt with in the body of the section itself. This clearly shows that in all other matters the Income-tax authorities cannot exercise the power ordinarily vested in a Civil Court. Similarly, they are under no obligation to conform to the procedure laid down in the Civil Procedure Code in respect of matters not expressly mentioned in Section 37. A right of appeal under the Act has been conferred by Section 30 of the Income Tax Act and the method of disposing of appeals and the powers to be exercised in connection therewith have been clearly defined in Section 31 of the Income Tax Act. These powers, among others, include enhancement of the assessment. Nowhere, however, has it been mentioned that an assessee is at liberty to withdraw an appeal which has once been presented under Section 30 of the Income Tax Act. If it were assumed that the power

of withdrawal of an appeal vested in an assessee on the general principles of law governing appeals, it would clearly nullify the powers of the Assistant Commissioner to enhance an assessment inasmuch as at any time that an assessee would be convinced that the Assistant Commissioner was disposed to enhance the assessment, he would withdraw the appeal and thus prevent him from proceeding any further with the matter. In other words, this would obviously lead to an absurd result. It is to avoid such an absurdity and similar other complications which might arise, that no power of withdrawal has been vested in the assessee. We are supported in our conclusion by *R. v. Income Tax Special Commissioners*; ex parte *Elmhirst*, which lays down that an appeal against an assessment cannot be withdrawn. It is true that that judgment had been given under a statute which is not in force here, but the principles governing the question are the same. In the words of Lord Wright at pp. 500-501 "it would indeed be a curious position if, notice of appeal having been given by that taxpayer in the hope of reducing his assessment, he should be able, when the information elicited shows quite conclusively that the assessment so far from being an overcharge, was an undercharge, to prevent the Commissioners from estimating or valuing or assessing his liability according to the true facts which have been elicited, or that they should be debarred from proceeding further to develop the facts so as to ascertain the true position..... Having a duty to examine the facts, they are bound to give effect to what appears to them to be the proper assessment to be made in view of those facts". We accordingly hold that the assessee was not competent to withdraw his appeal and in this view of the matter the second part of question No. 1 does not arise.

Coming now to question No. 2. The material portion of Section 34 reads as follows :—

"If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year.....the Income-tax Officer, may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains.....a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of Section 22 and may proceed to assess or re-assess such income, profits or gains....."

It is obvious that under this section no income, if it has escaped, can be touched after the period of limitation prescribed therein. On the one hand, this section arms the Income-tax

Officer with a special power to rectify his mistakes and to save the exchequer from any loss accruing from his negligence and on the other it protects the assessee against the arbitrary use of this section and sets a limit of time within which such mistakes can be rectified. Again, this section is confined to the items of income that have escaped and has no reference to the total income of the assessee. A notice issued under this section, therefore, pertains to those items only which have escaped assessment and to no others. If it was permissible to the Assistant Commissioner of Income-tax to add fresh items of income under different heads to the items already detected by him as having escaped, even though the limitation prescribed by Section 34 had expired, it would deprive the assessee of the protection afforded by Section 34. No doubt Section 31 empowers an Assistant Commissioner of Income-tax in general terms to enhance an assessment, but we do not consider that that power can be exercised irrespective of the limitations imposed by Section 34.

One of the cardinal principles of the interpretation of statutes may be given in the words of Maxwell as follows :—

“It is an elementary rule that construction is to be made of all the parts together, and not of one part only by itself,.....for the true meaning of any passage is that which (being permissible) best harmonises with the subject, and with every other passage of the statute. Perhaps as a general proposition the words of a statute should be construed in accordance with the *dictum* of Lord Watson, who says with regard to deeds, in an unrecorded case, ‘the deed must be read as a whole in order to ascertain the true meaning of its several clauses, and the words of each clause should be so interpreted as to bring them into harmony with the other provisions.....if that interpretation does no violence to the meaning of which they are naturally susceptible’”.

In *Nawal Kishore Kharaiti Lal v. Commissioner of Income Tax, Punjab*, a Division Bench of this Court held that the Commissioner when dealing with an appeal under Section 32 can pass orders only with respect to the subject-matter of the appeal and cannot *suo motu* proceed to enhance an assessment. It would be a curious state of affairs if what a Commissioner cannot do under Section 32, an Assistant Commissioner may be able to do under Section 31.

In *North British & Mercantile Insurance Co., In re*, a Special Bench of the Calcutta High Court held that when an assessee rightly objects to an assessment or re-assessment, the

powers of the Assistant Commissioner are limited to annulling it and do not extend to enhancing an assessment which the Income-tax Officer had no jurisdiction to make.

In *Jagarnath Therani v. Commissioner of Income Tax, Bihar & Orissa* a Division Bench of the Patna High Court held that under Section 31 of the Income Tax Act, an Assistant Commissioner of Income-tax has power to enhance an assessment made by an Income-tax Officer but he is not empowered to make a new assessment in appeal by adding new sources of income which were not the subject-matter of the appeal.

On these grounds we have no hesitation in holding that in the circumstances of the present case the Assistant Commissioner is not empowered so to enhance the income assessable under Section 34 of the Income-tax Act as to include the sum of Rs. 88,795 which has nothing to do with the subject-matter of the appeal before him.

Similarly, the Assistant Commissioner of Income-tax cannot make any direction under Section 31 (3) (b) so as to enable the Income Tax Officer to make a fresh assessment in relation to this sum. If in such cases an Assistant Commissioner of Income-tax can be considered to be empowered to do so, this would mean that he is empowered to override the express provisions of law as regards limitation provided for in Section 34 of the Income-tax Act. Had this been the intention of the Legislature it should have expressed itself in clearer terms. An income which has once escaped cannot be assessed or re-assessed after the expiry of the period of limitation. See *Ganesh Das, In re*, and *Ganga Sagar v. Emperor*. We, therefore, answer the third question also in the negative. The assessee will get his costs from the Commissioner.

[IN THE LAHORE HIGH COURT].

TULSI DAS NAGIN CHAND

v.

COMMISSIONER OF INCOME TAX, PUNJAB, N.W.F.
and DELHI PROVINCES.

SIR JAMES ADDISON and DIN MOHAMMAD, JJ.

March 1, 1938.

BEST JUDGMENT ASSESSMENT—NOTICE TO PRODUCE ACCOUNT BOOKS—RELEVANCY OF BOOKS CALLED FOR—A MATTER TO BE DETERMINED BY INCOME TAX OFFICER.

It is for the Income Tax Officer to determine what account books and documents are necessary to enable him to make an estimate of the income of an assessee, and an assessment under Section 23 (4) cannot be held to be invalid merely because some of the accounts called for which were not produced were irrelevant in the opinion of the assessee.

If an Income Tax Officer after calling for the previous accounts relating to the various businesses of the assessee utilises the accounts produced by the assessee in making his estimate, it cannot be said that those accounts which were not produced by the assessee were not required for the purposes of assessment.

What happens in a subsequent year cannot be taken to be a criterion for what should have happened in the previous year and if an order made by an Income Tax Officer is not open to objection on any legal ground it cannot be set aside merely on the ground that in any subsequent year he himself or his successor did what he refused to do previously.

Application under Section 66 (3) of the Indian Income Tax Act to require the Commissioner of Income Tax, Punjab to state the case of the applicant. [Civil Mis. No. 654 of 1937].

Kirpa Ram Bajaj for the Assessee.

J. N. Aggarwal and *S. M. Sikri* for the Commissioner.

ORDER.

This is a petition under sub-section (3) of Section 66 of the Income Tax Act praying for the issue of a mandamus to the Commissioner to state the case of the petitioner and to refer it to this Court. Originally eleven questions were formulated in the petition but the petitioner's counsel has now confined himself to the two questions stated below :—

“(1) Whether there has been any non-compliance with the terms of the notice issued to the petitioner under sub-section (4) of Section 22, and

(2) Whether in view of the fact that the assessment for the next year was based on the same material in the account books which were produced before the Income Tax Officer, the Income Tax Officer and the Assistant Commissioner were legally competent to assess the petitioner under sub-section (4) of Section 23.”

The facts giving rise to the two questions propounded above are as follows. The assessee is a Hindu undivided family trading in hardware at Ludhiana and in the neighbouring States. He submitted the usual return for 1932-33 on which he was duly

assessed on 2nd November 1932. In the course of assessment proceedings for the year 1933-34 it transpired that the assessee's income for 1932-33 had escaped assessment and that it had further been assessed at a low rate. The Income-tax Officer, who was then dealing with the case, thereupon issued a notice under Section 34 and called upon the assessee to submit a fresh return in relation to the assessable income. The assessee submitted a return but it was found to be incomplete. Thereupon, a notice under sub-section (4) of Section 22 was served on the assessee requiring him to produce all the account books relating to the various concerns in which the assessee was interested. With this notice only a partial compliance was made inasmuch as a large number of books dealing with the old accounts of certain concerns belonging to the assessee were withheld. Consequently the Income-tax Officer made an assessment to the best of his judgment under sub-section (4) of Section 23, but in order to arrive at the figure on which the assessment should be made, he referred to the account books which had been produced by the assessee and utilised certain materials appearing in those account books in arriving at his conclusion. The assessee made an application under Section 27 but the application was rejected by the Income-tax Officer on the 14th February 1937, and an appeal against that order also failed. On a petition being made under sub-section (2) of Section 66, the Commissioner came to the conclusion that no issue of law arose and consequently dismissed the petition.

The main contention of the assessee is that most of the books which were not produced were irrelevant to the enquiry and that even their absence had not been felt by the Income-tax Officer inasmuch as he was in a position to make the assessment on information furnished by the account books which were actually produced and that consequently it could not be said that there was any non-compliance with the terms of the notice issued under sub-section (4) of Section 22. In support of his contention he has relied on 5 I.T.C. 142; but neither does the contention raised by the assessee appear to us to be sound nor does the authority relied on by him advance his case any further.

Sub-section (4) of Section 22 empowers the Income-tax Officer to serve on any person contemplated by the sub-section a notice requiring him to produce such accounts or documents *as the Income-tax Officer may require*. Sub-section (4) of Section 23 enacts that if any person *fails to comply with all the terms of a notice issued under sub-section (4) of Section 22*, the Income-tax Officer

shall make the assessment to the best of his judgment. Reading these two provisions of law together the only conclusion that can reasonably be deduced is that it is the requirement of the Income-tax Officer which is to be satisfied by the assessee under sub-section (4) of Section 22 and not what the assessee thinks the Income-tax Officer, should, in the circumstances of the case, have required. In other words, the final arbiter of what is required is the Income tax Officer and not the assessee. If, therefore, there is any non-compliance with any of the terms of the notice issued under sub-section (4) of Section 22, the assessee makes himself liable to be assessed under sub-section (4) of Section 23. To put any other construction on the clear wording of the Statute as contained in sub-section (4) of Section 22 or sub-section (4) of Section 23 would amount to substituting the assessee for the income-tax authorities to determine what materials are necessary to be produced in order to enable the Income-tax Officer to arrive at a just estimate of an assessee's income. This could never have been the intention of the Legislature while enacting these provisions.

In 5 I. T. C. 142 the Income-tax Officer had based his assessment on the actual entries in the books produced by the assessee and had come to the conclusion that there was no extra income on which the assessee should have been assessed or that such income could have been discovered by the production of those books which had not been produced. Here, however, the circumstances are quite different and the Income-tax Officer has repeatedly observed that the profits have been concealed and that the non-production of some of the books required by him is deliberate. That case, therefore, is distinguishable on the grounds stated above. It may be that, as remarked by the learned Judges in that case, "the word, 'require' really means require as a piece of relevant evidence" and that it does not mean "that the Income-tax Officer should ask for documents or account books which he does not think to be relevant at all"; but, as observed in the same judgment an Income-tax Officer is entitled to call for documents which *in his* opinion would furnish him with relevant material for assessment of tax. It is a well-established rule of law that the income-tax authorities are the sole arbiters of fact and that the conclusions reached by them on questions of fact are not liable to be disturbed by any outside authority. It would, therefore, be entirely for the Income-tax authorities to determine what evidence they consider relevant for the purposes of their enquiry and to contend that a certain piece of evidence which they considered to be relevant

was not relevant at all to the matter at issue would be in a way to encroach upon their domain.

Similarly, if an Income-tax Officer, after calling for the previous accounts relating to the various businesses conducted by the assessee, utilizes the accounts produced by the assessee in making his estimate, it cannot be argued that those accounts which were not produced by the assessee were not required for the purpose of the assessment. An Income-tax Officer may refer to the accounts produced in order to arrive at an estimate of the assessable income or he may look into the accounts in order to justify his conclusion as to the falsity of the accounts submitted by the assessee; but, in our view, it is going too far to say that, if an Income-tax Officer utilized any account books in arriving at his estimate, those were the only relevant accounts which were necessary for his purpose and that he was not justified in asking for any other account books. The withholding of some of the account books which the assessee in this case had been called upon to produce amounted, therefore, to a non-compliance with the terms of the notice issued under sub section (4) of Section 22 and entailed all the penalties laid down in sub-section (4) of Section 23. In support of this conclusion reference may be made to 8 I.T.C. 297.

The second question can be disposed of on the short ground that what happens in a subsequent year cannot, be taken to be a criterion for what should have happened in the previous year, and that if an order made by the Income Tax Officer is not open to objection on any legal ground, it cannot be set aside merely on the ground that in any subsequent year he himself, or his successor, did what he refused to do previously.

We, accordingly, answer both the questions suggested by the assessee in the affirmative and dismiss this petition. The Commissioner will however, get his counsel's fee from the assessee which we estimate at Rs. 50.

Application dismissed.

[IN THE ALLAHABAD HIGH COURT].

GANESH LAL AND SONS, JEWELLERS, AGRA

v.

COMMISSIONER OF INCOME TAX.

COLLISTER, J., and BAJPAI, J.

February 14, 1938.

FLAT RATE ASSESSMENT—ACCOUNT BOOKS REJECTED—ASSESSMENT AT FLAT RATE—AMOUNT OF RATE NOT A QUESTION OF LAW—VERY HIGH RATE NOT SUFFICIENT GROUND FOR REFERENCE—JEWELLERY—HIGH RATE OF PROFITS—INDIAN INCOME TAX ACT (XI of 1922), Secs. 13, 66.

Under Section 13 of the Indian Income Tax Act, the Income Tax Officer is entitled in his discretion to reject the assessee's books and if he rejects the books and the principle of flat rate thereby becomes applicable, the amount of such rate is entirely in his discretion and is not a matter of law which can be referred to the High Court.

The mere fact that a high rate of profits has been applied will not by itself warrant the High Court in directing the Commissioner to state the case.

[The High Court refused to require the Commissioner to state the case though profits were assessed at a flat rate of 30 per cent. of the sale proceeds, and with regard to the sale of a particular piece of jewellery the profits were assessed at 60 per cent.]

Cases referred to :

FEROZE SHAH v. COMMISSIONER OF INCOME-TAX, PUNJAB [1933] (60 I.A. 325 ; I.L.R. 14 Lah. 682 ; 1933 I.T.R. 219 ; A.I.R. 1933 P.C. 198 ; 7 I.T.C. 25 : on appeal from 1931 I.L.R. 12 Lah. 166 ; 5 I.T.C. 198).

FEROZE SHAH v. COMMISSIONER OF INCOME-TAX, PUNJAB [1930] (4 I.T.C. 315).

Application under Section 66 (3) of Indian Income-tax Act to direct the Commissioner of Income-tax, U.P. to state a case.

Din Dayal (for whom *G. S. Pathak*) for the applicant.

N. P. Asthana for the opposite party.

JUDGMENT.

COLLISTER, J.—These are two applications under Section 66 (3) of the Indian Income-tax Act requesting this Court to direct the Commissioner of Income-tax to state a case for the decision of this Court.

The assesseees are a firm at Agra known as Ganeshi Lal and Sons. They are dealers in jewellery, embroidery, curious and *objects d'art* of various kinds. One of these applications relates to the year 1933-34 and the other relates to the year 1934-35. They can be disposed of together, as was done by the Assistant Commissioner and by the Commissioner.

The questions upon which we are asked to direct the Commissioner to state a case are as follows :

(a) Whether in view of the facts of the case the stock valuations should not have been accepted and whether the books could be legally rejected and an estimated profit could be rightly made on percentage basis under Section 13 of the Act?

(b) Whether the flat rate 30 per cent. was rightly taken by the learned Income-tax Officer for estimating net profit (less interest on borrowed capital) when the evidence before him in the shape of the books showed an average gross profit of 15 per cent?

In connection with Case No. 541 of 1936 we are also asked to have the question referred as to whether the rate of 60 per cent. which has been applied for the purpose of estimating the net profits of a particular article of jewellery was justified.

The facts are simple enough and are not in dispute. The gross sale proceeds for 1933-34 were Rs. 1,66,187 which included Rs. 70,000 on account of a pearl necklace. For 1934-35 the gross sale proceeds amounted to Rs. 2,41,781 which included Rs. 78,696 on account of a commodity purchased in partnership with another party.

It may be mentioned that in March, 1931, the assesseees for the first time valued their stock and prepared a stock book, according to which the total value of the stock in trade was approximately Rs. 14,00,000. The returns submitted by the assesseees for the years in dispute showed a loss, but they were not accepted by the Income-tax Officer. He did not accept the stock valuation and he had also refused to accept it for the previous year, i.e., 1932-33. Before rejecting it in respect to 1932-33 he selected 62 articles, 21 being from the jewellery department and 41 from the cloth and embroidery department and he asked the assesseees to prove their cost. The assesseees were only able to prove the cost of 14 out of the 41 items from the cloth and embroidery department; and as regards the items from the jewellery department, the assesseees filed a statement in respect to 9 of those items only, but were unable to establish the correctness of that statement.

Thereupon, the Income-tax Officer assessed profit at the rate of 30 per cent. of the sale proceeds; and he adopted the same principle in respect to the years 1933-34 and 1934-35, except as regards one article relating to the year 1933-34. This was a pearl necklace consisting of 109 pearls which had been sold to an American for Rs. 70,000. According to the stock book, the value of this article was Rs. 45,000 but the Income-tax Officer did not accept this valuation and assessed the profits from it at 60 per cent of its sale proceeds. He accepted the profits disclosed by the assesseees in respect to the commodity which had been purchased in partnership with another party in respect to the year 1934-35.

For the year 1933-1934 the Income-tax Officer assessed the business income at Rs. 12,926 and income from property at Rs. 3,828. For the year 1934-35 he assessed the business income at Rs. 31,311 and income from property at Rs. 4,563. These figures were arrived at after making allowance on account of the interest on borrowed capital. Deductions were then made from these amounts on account of insurance premia.

The assesseees appealed to the Assistant Commissioner of Income-tax but the appeal was dismissed. An application was then made to the Commissioner of Income-tax under Section 66 (2) of the Act requiring him to refer certain questions for the decision of this Court, but that application was disallowed by the Commissioner who was of opinion that no question of law arose from the order or decision of the Assistant Commissioner.

Learned counsel for the assesseees contends that questions of law do arise and he asks us to direct the Commissioner to state a case accordingly. He says that when the stock book of the assesseees was prepared, the value of articles recently purchased was entered therein according to the invoices; but as regards old family heirlooms and articles of little intrinsic, but high artistic or sentimental, value the assesseees had to appraise them according to the market prices as recognized and accepted among wholesale dealers. He pleads that it was open to the assesseees to put a valuation upon these articles to the best of their judgment and that the authorities are not entitled to object to such valuation so long as the total valuation does not exceed Rs. 14,00,000, which is said to be the total value of the stock in trade and in respect of which there is apparently no dispute. He argues that the assesseees are at liberty to distribute this Rs. 14,00,000 among the various articles as they please and that there can be no objection on behalf of the Income-tax authorities in respect to the valuation thus

allocated to any particular item so long as the whole does not exceed Rs. 14,00,000.

What we have to consider is whether this contention gives rise to any question of law. In *Feroze Shah v. Commissioner of Income Tax, Punjab and N. W. F. Province* (1931) a flat rate of profit of 32½ per cent had been applied. A similar rate had been applied in the two previous years without objection and it did not appear that the accounts for the year then in question were maintained on a different system. A Bench of the Lahore High Court observed :

“ Assuming, however, for the moment that no regular method of accounting was employed, it has not been shown in what particular manner the Income-tax Officer acting under the proviso (to Section 13) has failed in his computation of the profits. The matter is entirely within the discretion of the Income-tax Officer and unless it can be shown that such discretion had been illegally or arbitrarily exercised no point of law can possibly arise ”.

In *Feroze Shah v. Commissioner of Income-tax, Punjab and N. W. F. Province* (1933) a flat rate of 32½ per cent. on sales was applied since the rate of profit could not be deduced from the books. A similar rate had been applied in the two previous years and no objection had been made. At page 384 their Lordships of the Privy Council observe :

“ With regard to the flat rate of 32½ per cent., their Lordships are in agreement with the judgment of the High Court on that head. The principle of assessment at a flat rate not being contested, its amount must be for the Income-tax Officer to determine ”.

Under Section 13 of the Act the Income-tax Officer had discretion to accept or reject the assessee's books, and he rejected them. There is nothing apparently unreasonable or arbitrary in applying the rate of 30 per cent. upon sale proceeds, especially when no objection to the application of such rate for the year 1932-33 was made. If we think—as we do—that the Income-tax department was entitled in its discretion to reject the books and if the principle of a flat rate thereby became applicable, the amount of such rate was entirely in the discretion of the Income-tax authorities, as held by their Lordships of the Privy Council in the case above referred to.

There remains the question of the pearl necklace. *Prima facie* the rate of 60 per cent. appears to be high; but in the absence of anything to suggest the contrary, we must assume that the Income-tax authorities used their discretion reasonably and not

arbitrarily and that their appraisement of the value of the article was based on their experience in such matters. In Sundaram's *Law of Income-tax*, Fourth Edition, at page 476, the learned author says:

"The basis of flat rates is obviously the previous practice and experience of the Department in regard to similar trades."

The Income-tax Officer in the present case did not believe the assessee's assertion that they were unable to say what the pearls had cost them. He also observes:

"As far as pearls are concerned, the value of a necklace is determined by the matching of the pearls contained in it. Well-matched pearls of comparatively low cost may make up a necklace of much greater value than ill-matched pearls of greater value would do. The margin of profit is thus very great, and I think it may be anywhere between 20 per cent. and 80 per cent. For the matter of that it may be even more. In any case, as I mentioned above, the dealer has to know what it actually cost him to make a necklace in order to enable him to fix a price for it."

The Assistant Commissioner in the course of his order says:

"The Income-tax Officer was, therefore, quite justified in having applied a rate, and the rate 60 per cent. applied to the sale of this precious piece of jewellery does not appear to be at all excessive. It is to be noted that rates of profit are generally high in the case of articles of luxury, and they are very much higher in the case of jewellery, and particularly of a piece of jewellery of this nature."

The Assistant Commissioner might have added that the rate of profits is often exceptionally high where the vendee is a rich American. In any case, the mere fact that a high rate of profits has been applied will not by itself warrant this Court in directing the Commissioner to state a case. Moreover, it is to be observed that in their application to the Commissioner under Section 66 (2) there was no request to him to refer to this Court any question as regards the rate of 60 per cent. which had been applied in respect to this pearl necklace; the application was concerned exclusively with the flat rate of 30 per cent. which had been applied in respect of other articles.

For the reasons given above we are of opinion that no question of law arises out of the order or decision of the Assistant Commissioner and we accordingly dismiss these two applications with costs. Counsel for the Department is entitled to Rs. 75 as his fee in each case. He should file his certificate within six weeks.

Application dismissed.

[IN THE CALCUTTA HIGH COURT.]

B. K. PAUL & CO., *In re.*SIR HAROLD DERBYSHIRE, C. J., KHUNDKHAR, J., and
MUKHERJEA, J.

February 24, 1938.

LOSS—SUCCESSION TO BUSINESS—BUSINESS RESULTING IN
LOSS—TRANSFEROR'S RIGHT TO SET OFF LOSS AGAINST OTHER
INCOME—EFFECT OF TRANSFER AFTER EXPIRY OF ASSESSMENT
YEAR—INCOME-TAX ACT (XI OF 1922), SECS. 14, 26 (2).

The assesseees, a Hindu undivided family owned real property, securities, shares and some 17 businesses. During the accounting year 1932-33, the assesseees received income from real property, securities and shares but there was a loss of Rs. 2,18,682 in the businesses. The assesseees were not assessed during the year 1933-34 owing to some delay on the part of the Department, but were assessed on September 28, 1934. Meanwhile, on April 14, 1934, 16 out of the 17 businesses were transferred to 4 new limited companies and the Income-tax Department refused to allow the assesseees to set off the losses incurred in the 16 businesses against their other income on the ground that under Section 26 (2) as the businesses had been transferred the successors in business, viz., the four companies, could alone be assessed in respect of these businesses and so they alone could claim the right of set off.

*Held, that as there were no profits to be assessed in respect of the 16 businesses Section 26 (2) had no application to the case and the assesseees were entitled under the provisions of Section 24 (1) to have the losses in respect of these businesses set off against their other income.**

MUKHERJEA, J.—*It is not necessary in order to attract the operation of Section 26 (2) that the succession must take place within the year of assessment. But if there is no profit in the business transferred in respect of which an assessment could be made on the successor Section 26 (2) does not come into operation at all.*

Cases referred to:

COMMISSIONER OF INCOME-TAX, MADRAS v. BEST & Co. [1931] (I.L.R. 55 Mad. 882).

COMMISSIONER OF INCOME-TAX, MADRAS v. NACHAL ACHI [1933] (I.L.R. 57 Mad. 357; 1933 I.T.R. 32; A.I.R. 1934 M. 63).

* [Note:—The Income-tax Amendment Bill, 1938, removes all doubts by providing that in the case of succession to business only the person incurring the loss can set it off: See Sec. 17 (2)—Ed.]

BHOGILAL HARGOVINDAS PATEL v. COMMISSIONER OF INCOME-TAX, BOMBAY [1937] (1937 I.T.R. 555; 9 I.T.C. 110).

MAHARAJA OF DARBHANGA v. COMMISSIONER OF INCOME-TAX [1934] (1 I.A. 312; 1934 I.T.R. 845; 13 Pat. 637).

RAM RAKHA MAL & SONS v. COMMISSIONER OF INCOME-TAX, PUNJAB [1937] (I.L.R. 1937 Lah. 325; 1937 I.T.R. 137).

Case stated by the Commissioner of Income-tax, Bengal, under Section 66 (3) of the Indian Income-tax Act.

STATEMENT OF CASE.

"As directed by Their Lordships, the Hon'ble the Chief Justice and the Hon'ble Mr. Justice PANCKRIDGE in their order, dated the 30th July 1936, passed under Section 66 (3) of the Income-tax Act, the following statement of case has been drawn up and is submitted for their Lordships' decision on the following question of law as stated in that order :—

"Where an assessment proceeding for 1933-34 is started but not completed during that year and during its pendency in the next year the assessee hitherto carrying on business is succeeded in such capacity by another person, whether set off under Section 24 of the Indian Income-tax Act for the loss sustained in that business during the year 1932-33 can be claimed by the assessee or whether such set off will be allowable only to the successor."

2. **Facts of the case.**—The matter arises out of an assessment made for the year 1933-34 on Messrs. B. K. Paul and Company, a Hindu undivided family, on the income of the year of account Bengali 1339 which ended on the 13th April 1933. The sources of income on which the assessment has been made are—

- (1) House property. (2) Interest on securities. (3) Dividends. (4) Shares in partnership concerns. (5) Other sources.

In previous years this Hindu undivided family, that is, the assessee had been assessed, among others, on income from business, and up till April 1934 the assessee had 17 different businesses owned in their entirety by this Hindu undivided family as such. The names of these 17 different businesses are given below :—

Name of Business.	Nature of Business.
1. B. K. Paul and Son	Head Office.
2. B. N. Paul and Brothers	Wine Business.
3. B. K. Paul and Son	Dentists.
4. "	Opticians.
5. "	Watches.

6.	B. K. Paul and Son	Edward Industrial Works (Soti-food).
7.	"	Great Homeopathic Hall.
8.	"	Ayurvedic Pharmacy.
9.	"	Printing Press.
10.	"	New Medical Hall.
11.	"	Khograputty Branch.
12.	"	Compounding Department.
13.	"	Research Laboratory.
14.	"	Agency Department.
15.	"	Eagle Chemical Works.
16.	Bhutnath Paul and Brothers	Tonic Department Branch.
17.	Jagat Chandra Dhar and Company.	Chittagong Branch.

Besides the above businesses the assessee had partnership interest among others in the following partnership concerns :

a 12 annas share in B. N. Paul and Company and a 7 annas share in M. R. Paul and Company.

There are other partnership concerns in which the assessee is interested, but so far the present case is concerned, it is only the above two partnerships which would come in for discussion.

3. On the 11th April 1934 the four following private limited companies were formed and the business activities of the 17 businesses mentioned before were taken over on the 14th April 1934 by these limited companies in which the shareholders are the members of the Hindu undivided family :—

(1) Messrs. B. K. Paul and Company, Limited. (2) Messrs. B. K. Paul and Company (Research Laboratory), Limited. (3) Messrs. B. K. Paul and Company (Agency) Limited. (4) Messrs. B. K. Paul and Company (Edwards Tonic) Limited.

The Income-tax Officer treated all these 17 businesses, as having been taken over from the Hindu undivided family by these limited companies. The Assistant Commissioner of Income-tax, however, in appeal found that the last of the 17 businesses, *viz.*, Jagat Chandra Dhar and Company, the Chittagong branch, was not so taken over by the limited companies, but remained the property of the Hindu undivided family as such and accordingly, by his appellate order, dated the 23rd January 1935, he allowed the loss sustained in respect of the Chittagong branch to be set off against the assessee's total income; such loss was ascertained to be Rs. 4,635.

4. In respect of the assessment year 1933-34 for the income of the year 1339 B. S., the assessee had filed his return on the 6th December 1933 showing the following details :—

2. Interest on securities (including debentures already taxed).	4,709-5-4 including 2,608-13-0 interest on securities for business.
3. Interest on securities of the Government of India or of Local Governments declared to be income tax free.	
4. Property as shown in detail in Schedule A.	1,15,024 6 6
5. Business, trade, commerce, manufacture, or dealing in property, shares or securities (detailed as in note 5).	2,16,073 14 7 Loss
6. Profession	...
7. Dividends from Companies (net)	6,095 0 0
8. Interest on mortgages, loans, fixed deposits, current accounts, etc.	...
9. Ground rent	...
10. Any source other than those mentioned above including any income earned in partnership with others.	Shall submit hereafter

Total	1,15,024	6	6
Loss	2,18,682	11	7

25,582-5-0 Net Loss
1,03,658-5-1

It is not clear how the figure of net loss of Rs. 1,03,658-5-1 shown in the return was arrived at. Pursuant however to a notice under Section 22 (4) of the Act, dated the 15th February 1934, the assessee produced his account books and it appears from the order sheets of the case that the accounts were under examination between the period 7th March 1934 to the 15th September 1934, this delay being primarily due to the inability of the assessee's representative to appear on the dates fixed and also, to some extent, to the fact that the Income tax Officer who had partly

dealt with the matter some time up to the middle of May 1934 was succeeded about that time by another Income tax Officer who on an examination of the account books and other materials placed before him from time to time by the assessee made the assessment on the 28th September 1934 on a total income of Rs. 1,38,229.

5. Before the Income Tax Officer the assessee put forward the claim that loss to the extent of Rs. 2,16,073-14-7 referred to in his return accrued to the assessee as the Hindu undivided family and not to the limited companies and as such this loss should be considered as a legitimate set off against the total income of the assessee, the Hindu undivided family. The Income tax Officer in making the assessment did not treat the loss as having accrued to the Hindu undivided family by reason of the provisions of Section 26 (2) of the Act, the business having been found to have been transferred to the limited companies at the time of the assessment and computed the assessee's total income at Rs. 1,38,229 without taking into account the losses from the said businesses. As regards the two partnership concerns the Income-tax Officer allowed a set off of 12 annas share of loss in B. N. Paul and Company amounting to Rs. 4,603 and included 7 annas share of profit in M. R. Paul and Company of a sum of Rs. 2,035. It was claimed at the appeal stage that as at the time of the assessment the Hindu undivided family had become the sole owner of these two partnership concerns, the entire loss in the first and the whole of the profit in the second should have been taken. This claim was not made at the assessment stage. Further the assessment of the partnership business styled B. N. Paul and Company for the year 1933-34 had already been completed on the 14th October 1933 on a loss of Rs. 6,138. The share of the Hindu undivided family being 12 annas, a proportionate loss amounting to Rs. 4,603 was set off in the assessment of the Hindu undivided family made by the Income tax Officer in September 1934. Again as regards the partnership business styled M. R. Paul and Company also the assessment for the year 1933-34 had already been made on the 16th October 1934 on an income of Rs. 4,652. The share of the Hindu undivided family being 7 annas the Income-tax Officer took the proportionate figure to be Rs. 2,035. These two assessments (made on the 14th October 1933 and 16th October 1933) were not appealed against and were therefore final. As said before the present claim was not made at the assessment stage. The Income tax Officer, therefore, did not and could not reopen the assessments and take in the assessment of the assessee Hindu undivided family

any amount other than the proportionate figures of loss and profit of the aforesaid partnership concerns.

6. The assessee's appeal against this non-inclusion of losses with respect to the said 17 businesses (excepting the last one as said in paragraph 3 above), as also his claim in respect of the two partnership concerns proved infructuous. His application under Section 66 (2) of the Act was also rejected and on his applying to their Lordships under Section 66 (3) their Lordships' direction was to submit a statement of case in respect of the question of law stated in paragraph 1 above. Before the Income tax Officer the contention raised by the assessee was that there was no succession, that there had been no transfer of the property of the assessee to the limited companies and that the original assessee (Hindu undivided family) still being in existence no question of succession arose. But at the later stages, *i.e.*, in appeal before the Assistant Commissioner and before the Commissioner the assessee withdrew from that position, and, while admitting that there had been a succession, argued that in the circumstances of this case, not the succeeding companies but the assessee, Hindu undivided family, should be assessed on the results of the businesses carried on in the year of account.

7. **Opinion of the Commissioner.**—The answer to the question will in my humble opinion very much depend upon what construction is put upon Sections 26 (2) and 24 (1) of the Indian Income tax Act. Section 24 (1) lays down that "Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year." The term "assessee" is defined in Section 2 (2) to mean a "person by whom income tax is payable". In my opinion, the use of the word "assessee" in Section 24 (1) is significant. The section does not say that where any *person* sustains a loss he shall be entitled to have the amount of the loss set off against his income, etc. It speaks of an '*assessee*' sustaining a loss of profits or gains. In my opinion the section allows set off only to the person who would have been the assessee had there been profits or gains under the head under which he had sustained a loss. The present assessee is the Hindu undivided family. There has been loss of profits in the relevant year under the head business in respect of the sixteen businesses abovementioned. The Hindu undivided family can claim set off for this only if this family would have been the person liable to pay income tax in

respect of the profits or gains of these businesses, had there been profit, instead of loss, in these businesses during the particular year.

The question therefore is who would have been the assessee in case there were profits or gains of these businesses. Admittedly the Hindu undivided family hitherto carrying on these businesses was succeeded in such capacity by the limited companies above named and it is an admitted fact that such succession took place during the pendency of the present assessment proceedings. Section 26 (2) enacts :—

“Where at the time of making an assessment under Section 23 it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year.”

It has been held by their Lordships of the Privy Council in the case of *Maharajahdhiraj of Darbhanga v. Commissioner of Income Tax, Bihar and Orissa*, (61 I.A. 312) that the expression “at the time of making the assessment” means “in the course of the process of assessment.” This course of assessment commences when notice under Section 22 is served, and continues until some order of assessment is made. The succession in the present case admittedly took place within such course of the process of assessment. According to the plain language of the section therefore, the assessment *shall* have to be made on the person succeeding as if he had been carrying on the business.....throughout the previous year. The section thus makes it obligatory on the part of the Income-tax authorities to make assessment on the person succeeding. In this connection I would respectfully invite their Lordships’ attention to the following observations of BEASLEY, C.J., in the case of the *Commissioner of Income Tax, Madras v. Best and Company, Limited*, (55 Mad. 832) :—

“Section 26 was designed for the purpose of making somebody assessable to income-tax and the whole scheme of the Act is not to assess two people at the same time but is to find somebody who is either properly assessable or more conveniently assessable; and what Section 26 (2) says is that where a person who was not the former owner of a company is found to be owning that Company in the year of assessment *that person is to be assessed*. That is not only a convenient course but seems to me to be a just one,

Upon whom the burden is ultimately to fall is a matter of arrangement between the vendor company and the purchaser company."

The Bombay High Court had occasion to consider a similar question in a very recent case (decided on the 17th October, 1939) namely, the *Commissioner of Income Tax, Bombay v. Bogilal Hargovandas Patel*. In this case also there was succession within the meaning of Section 26 (2) and their Lordships had to consider the application of Section 24. In this *BRAUMONT, C.J.*, observed:—

"Now, at the time of making the assessment on the present assessee, it was found by the Income-tax Officer that the assessee had been carrying on this cigarette business and had been succeeded in such business by the purchasing company, and the section, therefore, provides that the assessment shall be made on the purchasing company, as if it had been carrying on the business throughout the previous year, that is during the whole of the year 1933 and as if it had received the whole of the profits of that year. Where the facts bring a case within Section 26 (2), Section 24 only applies in my opinion to the assessment of the successor."

It is argued on behalf of the assessee that Section 26 (2) does not apply unless there are profits. In fact there is no evidence in this case as to whether or not there were profits in this business for the whole of the year. We do not know what the position was during the last three months. There is no evidence that there were no profits made, and that therefore no assessment on the purchasing company was necessary, and in the absence of evidence to that effect, it seems to me that the Income-tax Officer was quite right in saying that the section applied. I think the effect of the section is undoubtedly to make the successor to the business liable to the assessment for the whole of the year in question in respect of the business transferred. It is true that the section does not mention losses, but clearly these will have to be brought in for the whole of the year against the profits of the year. It is not necessary to deal with the question whether Section 26, sub-section (2), would apply if there were no profits in respect of the business transferred, and therefore, no assessment was necessary on the successor, assuming that he had no other source of income. On the facts proved in this case, I think that the Income-tax Officer was right in saying that it is the purchasing company which must be treated as carrying on the business for the whole of the year, and is, therefore, the person entitled to

any set off in respect of losses for that year, and that the present assessee is not entitled to set off any losses incurred in respect of this business against his assessable income in the year in question."

In the same case BLACKWELL, J., observed as follows :—

"It seems to me that having regard to sub-section (2) of Section 26 where a person carrying on any business has been succeeded in that business by another person he is not entitled to claim the benefit of sub-section (1) of Section 24 at all. In my view, it is not then open to him to contend that he, as an assessee, has sustained a loss of profits in the business which he has transferred, although there was a loss at the time of the transfer.

It has been contended by Sir Jamshedji Kanga, that unless it is shown that the successor in the business had made profits, it would still be open to the predecessor in the business to claim that he had sustained a loss of profits on the ground that no assessment in such event could be made on the successor. Speaking for myself, I do not think this is the true or proper construction to be placed upon sub-section (2) of Section 26. In my view, that sub-section means that where a business has been transferred, the Income-tax Officers are entitled to call upon the successor to make a return. For the purpose of ascertaining whether the successor has made profits for the year, any losses previously sustained must be taken into account. It seems to me that it would be very strange if, though the successor is to be deemed to have been carrying on the business for the whole of the year and is entitled to take into account any losses made in the business before the transfer for the purpose of the return, nevertheless the predecessor in business, another assessee, should be entitled to bring into his return the losses made prior to the transfer. In my judgment, such an interpretation of the section is so unreasonable that unless one is compelled by the words used to place such an interpretation on it, the Court ought to decline to do so."

(As the ruling does not appear to have been reported as yet in any authoritative publication, I have ventured to put in rather lengthy quotations therefrom).

8. In my humble submission, the provisions of Section 26 (2) require that in case of succession to a business the Income-tax Officer must make the assessment on the person who has succeeded to the business concerned. The present assessment before the Income-tax Officer was not the successor (the limited companies). The profits or gains or "loss of profits or gains" of these businesses

were therefore not before the Income-tax Officer at all. It was not competent for him, while assessing the Hindu undivided family to take into account the losses if any which the businesses had suffered. Such losses, if any, will be considered by the Income-tax Officer on whom the duty of assessing the limited companies will fall. I would in the circumstances respectfully submit that in view of the provisions of Section 26 (2) of the Act and the recent decision of the Bombay High Court in the case of Bhogilal Har. govindas Patel cited above, their Lordships will be pleased to hold that so far as the present assessee is concerned he is not entitled to claim a set off under Section 24 (1) of the Income-tax Act, of loss, if any, sustained in the businesses which were not the assessee's at the time of the assessment but were transferred to the four limited companies.

9.. I append to the statement of the case copies of the following documents :—

(a) The assessment order. (b) Grounds of Appeal. (c) Appellate order. (d) Application under Section 66 (2). (e) Order passed by the Commissioner under that section. (f) Application under Section 66 (3). (g) Order under Section 66 (3)."

JUDGMENT.

DERBYSHIRE, C. J.—The assessees, Messrs. B. K. Paul and Company, are an undivided Hindu family. Prior to April 14, 1934, the assessees owned real property, Government securities, shares in private companies and some 17 businesses which either made or sold drugs and the like.

During the accounting year ("the previous year") which ended on April 13, 1933, the assessees received income from the real property, Government securities and shares in the companies, but the 17 businesses each suffered losses. The assessees were not assessed during the normal assessment year which ended on March 31, 1934, owing to a delay on the part of the Income-tax Officer. On April 11, 1934, four private limited companies were formed, the shareholders being members of the Hindu undivided family. On April 14, 1934, 16 of the 17 losing businesses were transferred to the four new companies. On September 28, 1934, the Income-tax Officer made an assessment on the assessees in respect of their income, profits and gains from the real property, Government securities and (old) company shares in respect of the year ending April 13, 1933. The amount of the assessment was Rs. 1,38,229. During the same accounting year the losses in the

17 businesses amounted to Rs. 2,18,682. The assessees claimed to set off this loss against the above mentioned gains during the same year. The Income-tax Officer allowed the assessees to set off the loss in the 17th business which was not transferred to any of the four new companies, but refused to allow the set off of the losses of the 16 other businesses transferred to the four new companies, on the ground that there had been a succession under Section 26 (2) of the Act and that any right of set off had passed from B. K. Paul & Co., under the succession. The assessees B. K. Paul & Co., relied on Section 24 (1) of the Act, and the Income-tax authorities on Section 26 (2) which are set out below :

Section 24 (1): "Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year."

Section 26 (2): "Where at the time of making an assessment under Section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year."

The question submitted to the Court is as follows :

"Where an assessment proceeding for 1933-34 is started but not completed during that year and during its pendency in the next year the assessee hitherto carrying on business is succeeded in such capacity by another person whether set off under Section 24 of the Indian Income Tax Act for the loss sustained in that business during the year 1932-33 can be claimed by the assessee or whether such set off will be allowable only to the successor."

In my opinion, it is, as Section 24 (1) specifically states, the "assessee who sustains a loss" in any year, who is entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year. Here B. K. Paul & Co. were assessed on September 28, 1934, in respect of their income, profits or gains from real property, interest on Government securities and dividends from (old) companies during the accounting year ending April 13, 1933. B. K. Paul & Co., undoubtedly owned the 16 losing businesses throughout the whole of the same accounting year and therefore sustained a loss during that same

year. It seems to me that B. K. Paul & Co., come precisely within the words of Section 24 (1).

It is true that in the accounting year next but one following, the four new companies which had no existence during the accounting year ending April 13, 1933, succeeded to the 16 businesses. Yet it cannot be said that these four companies sustained a loss in the year ending April 13, 1933; they were not in existence in that year and were neither making gains nor sustaining losses. Cases may arise in which there will be a conflict as to the right to the set off as between the transferor and the transferee of a business which has suffered losses during the accounting year. The terms and circumstances of the transfer may indicate whether there has been a succession within Section 26 (2) and what the rights of the respective parties are in such cases. No such conflict arises here in my opinion and I do not propose to anticipate it.

The assessee will get the costs of the reference. Hearing fee seven gold mohurs.

KHUNDKAR, J.—I Agree. I have had the advantage of seeing the judgment just pronounced by My Lord the Chief Justice and also that which my learned brother Mr. Justice MUKHERJEE proposes to deliver. As the facts are fully set out in those judgments, I do not repeat them. I desire only to add a few observations on one aspect of the case.

Section 24 in clear terms gives to an "assessee" the right to set off a loss of profits or gains in any year against income, profits and gains in that year. The undivided family in this case is the assessee whose return the income-tax authorities have under consideration, and who in fact was on the 28th September, 1934, held to be *the person by whom income-tax was payable*, in respect of the accounting year 1932-33; but in the assessment year 1933-34, it is to be noted that the position of the undivided family was exactly the same in the two years 1932-33 and 1933-34 in regard to the sources of its income, profits or gains, as well as in regard to the heads of its losses. In other words, throughout the whole of these two years the income, profits or gains of the undivided family were derived from properties and securities and throughout the whole of these two years it admittedly was and continued to remain the owner of 17 drug concerns which were productive of losses in 1932-33. The assessment proceedings were commenced on the 18th May 1933 though the final order of assessment was not made till the 28th September 1934.

In these circumstances, it appears to me that to refuse to allow the set off which the undivided family claimed was *prima facie* a negation of the right which Section 24 (1) expressly gave to it as an assessee. An assessee it undoubtedly became when the order of assessment was passed upon it. But it has been contended that that right is taken away by Section 26 (2) which says that where at the time of making an assessment under Section 23 it is found that the person carrying on any business etc., has been succeeded in such capacity by another the assessment shall be made on such person succeeding etc. For, upon an examination of the facts it becomes very clear that at the material time no order of assessment could in the circumstances of this case have been made upon the limited companies which had succeeded to the ownership of the drug concerns for the plain and simple reason that those companies never had any income from any source whatever, and were successors to the ownership of businesses which had been during the year in question productive only of loss.

In the Bombay and Madras cases cited by the Commissioner there are observations of a somewhat general nature which seem to be opposed to the view I have stated. Those observations are authority for the decision on the special facts of the cases to which they applied, and the situation which has arisen in this case was not present before the judges who made those observations. In the case of the *Commissioner of Income-tax, Madras v. Best & Co.*, no question as to a right of set off under Section 24 arose for consideration. As to the case of *Bhogilal Hargovandas Patel v. The Commissioner of Income-tax, Bombay*, it was not established, as it has been here, that at the time in question an order of assessment could not have been passed upon the successors. If that had been proved a very different situation would have arisen. The Court would then have been called upon to consider whether the words "the assessment shall be made on such person succeeding" in Section 26 (2) was not entirely inapplicable as there was nothing upon which an assessment could be based. Chief Justice BEAUMONT evidently envisaged such a situation and observed that the facts of that case did not give rise to it, for he says:

"There is no evidence that there were no profits made and that therefore no assessment on the purchasing company was necessary, and in the absence of evidence to that effect, it seems to me that the Income-tax Officer was quite right in saying that the section applied". Chief Justice BEAUMONT has in fact expressly

distinguished the question which he was considering from a question of the kind which has arisen here, for he goes on to say :

“ It is not necessary to deal with the question whether Section 26 sub-section (2) would apply if there were no profits in respect of the business transferred and therefore no assessment was necessary on the successor, assuming that he had no other source of income.”

It is, I think, desirable to say a word about the opinion of the Commissioner, which is that the section allows set off only to the person who would have been the assessee had there been profits or gains under the head under which he has sustained a loss. According to the definition in Section 2 (2) “ ‘assessee’ means a person by whom income tax is payable”. The language in my judgment does not support the Commissioner’s view which would embrace not only person liable, but also all persons who would be liable to income-tax in a certain eventuality, that is, had there been profits or gains. If the facts of this case are to be accepted, the limited companies did not come within the meaning of the words “person by whom income-tax is payable” because they never had any income from any source. Upon the facts established in this case the limited companies would not obtain any benefit out of the right of set off given by Section 24. Yet upon the argument advanced on behalf of the Income-tax authorities, the joint Hindu family from which the limited companies took over the businesses would have to be denied that right. Speaking for myself, I think there is something inherently wrong in this and such a result could never have been intended.

MUKHERJEA, J.—I agree with my Lord the Chief Justice in the decision which he has arrived at, and I desire to give shortly my own reasons in support of the same.

This reference has been made by the Commissioner of Income tax, Bengal, under Section 66 (3), Income-tax Act, in pursuance of an order passed by this Court on 30-7-36.

The material facts may be shortly stated as follows :

Messrs. B. K. Paul & Co., who admittedly constitute an undivided Hindu family and were assessed as such in previous years were called upon to furnish a return of its income for the year 1939 B. S. (1932-33) which was taxable in the year 1933-34. On 6-12-1933, a return was filed showing three sources of income which the family owned, *viz.*, (1) house property (2) securities and shares in limited companies and (3) seventeen businesses, all of which related to manufacture and sale of drugs. The first two

items showed a profit of 1,15,024-6-6 pies, but the loss on the 3rd item came up to 2,18,682-11-7 resulting in a net loss to the extent of 1,03,658-5-1. There was a notice on the assessee to produce its account books which were examined in March 1934, but no order of assessment was passed within the financial year 1933-34, probably because, as the Commissioner says, the case not being a revenue producing one, was not considered to be sufficiently urgent. On 14-4-1934, the businesses owned by this Hindu Joint family, with one exception, were transferred to 4 private limited companies. The Income-tax Officer passed his assessment order on 28-9-34. He assessed the family upon the profits obtained by it from the first two sources of income mentioned above, and refused to give a set off in respect of the loss on businesses suffered by it. He took his stand upon Section 26 (2), Income-tax Act, and was of opinion that as at the time of making the assessment, the businesses owned by the family were transferred to other persons, the assessment in respect of the businesses must be made on the succeeding companies, and as the family could not be regarded as assessee in respect of the same, it could not claim any set off as was provided for in Section 24 of the Act. This view was upheld by the Assistant Commissioner on appeal. The assessee then made an application to the Commissioner for a reference to the High Court under Section 66 (2), Income-tax Act. This was refused on 11-4-35. Subsequently there was an application to this Court under Section 66 (3), Income-tax Act, and in pursuance of the order of this Court, the present reference has been made. The question referred to our decision stands thus :

“ Where an assessment proceeding for 1933-34 is started but not completed, during that year, and during its pendency in the next year, the assessee hitherto carrying on business is succeeded in such capacity by another person, whether set off under Section 24 of the Income-tax Act for the loss sustained in that business during the year 1932-33 can be claimed by the assessee, or whether such set off will be allowable only to his successor ”.

The Commissioner has expressed his opinion adversely to the assessee. According to him, the loss sustained by the assessee on the various businesses owned by it, could not be taken into consideration in determining the profits or losses of the undivided Hindu family, as the assessment in respect of the businesses must, under the mandatory provision of Section 26 (2), Income-tax Act, be made on the successors. He has relied for this view upon certain decisions of the Madras and Bombay High Courts, which

are to be found reported in *Commissioner of Income-tax, Madras v. Best & Co.* and *Bhogilal Hargovandas Patel v. Commissioner of Income-tax, Bombay*.

Mr. Banerjee, who appears for the assessee has challenged the propriety of the view taken by the Commissioner, and has asked us to hold that his clients are entitled to claim set off under Section 24, Income-tax Act, Section 26 (2) having no application to the facts of the present case. His contention in substance is that to attract the operation of Section 26 (2) which makes it obligatory on the Income-tax Officer to assess the person who has succeeded to any profession, business, or vocation, the succession must take place within the year of assessment; and if as here, it takes place, after the tax year has expired, Section 26 (2) would have no application. It is not disputed that there are no clear words to that effect in the sub-section itself, and the only thing necessary to attract its operation, is the discovery of the fact of succession by the Income-tax Officer when the assessment is made. Mr. Banerjee argues, that a limitation, as suggested by him, must be implied, as otherwise it would lead to absurd and anomalous consequences. A case can be imagined, he says, when the assessment is made three or four years after the expiry of the tax year, and if just before that a transfer of, or succession to, a business takes place, it would be absurd to suggest that the transferee who had nothing to do with the business in the year of accounting would be deemed in the eye of law to have received the whole of the profits of the previous year. I must say, that at first, I was tempted to take the view that Section 26 (2) contemplates a case where the succession takes place during the previous year as defined in Section 2 (11), and it is to avoid a splitting up of the income or profits earned during that period, that the legislature makes the assumption that the transferee or successor received the whole profits of the previous year. The last two lines of the sub-section may lend an apparent countenance to this view, but the clear words at the beginning make it impossible for me to accept this interpretation as correct. The only material time for purposes of the sub-section is the time of making the assessment, and if there is discovery at that time of a succession or transfer, for which no date has been specified by the legislature, the provisions laid down in the sub-section, if it is otherwise applicable, would be attracted, and the fiction would be that the transferee carried on the business during the whole of the previous year and received all the profits, even though that fiction is manifestly contradictory to facts.

It may be that the intention of the legislature was to find out somebody who was more justly or conveniently assessable, and under the circumstances set out in Section 26 (2) the successor is deemed to be the more convenient or proper person to be assessed than his predecessor.

The case relied upon by the Commissioner may be distinguishable on facts, as in neither of them the transfer or succession took place after the expiry of the year of assessment, but the pronouncement of the Judicial Committee in *Maharaja of Darbhanga v. Income Tax Commissioner* (61 I.A. 312) has in my opinion placed the matter beyond the pale of controversy. The process of assessment begins, as their Lordships have said, with the service of notice under Section 22 (2) and it continues until some order of assessment is made. If therefore, after the aforesaid notice has been received by the assessee and before filing a return he dies, and is succeeded by a person, it would be competent to the Income-tax Officer to find, if the evidence justified the finding, that the person on whom the notice was served had carried on a business, and was succeeded in that capacity by another person. The same view was taken in *Commissioner of Income-tax, Madras v. Nachal Achi and Ram Bakha Mal & Sons v. Commissioner of Income-tax, Punjab*, in both of which the succession took place after the close of the year of assessment. The contention of Mr. Banerjee is, therefore, not tenable.

But even though I cannot accept the argument of Mr. Banerjee, it does not necessarily follow that the assessee is not entitled to claim set off in the circumstances of the present case. The Advocate General has argued that once it is found by the Income-tax Officer at the time when he makes the assessment that there has been a succession to a particular business, he cannot take the profit or loss of that business into consideration any further, and cannot grant a set off to the assessee, who no longer remains an assessee in respect of that business. It is incumbent upon him to ignore this item altogether so far as the assessee is concerned, and it can be taken into account only in assessing the successor, whom he is bound to assess under Section 26 (2), Income-tax Act.

The proposition requires to be carefully examined. Section 24, Income-tax Act, in clear words gives a right of set off to an assessee who suffers loss under any of the heads mentioned in Section 6. It seems that the word "assessee" has not been used here in the strict sense of a person by whom income-tax is payable, but means and signifies the person against whom assessment proceedings

have been started and who has been asked to give a return of his total income during the previous year under Section 22 (2), Income-tax Act. If such person sustains a loss of profits or gains under any of the heads of income, he shall be entitled to have the amount of loss set off against his income, profits or gains under any other head. In other words, his total income will be shown in the return by deducting the losses from the profits earned and he can be assessed on the balance, if any, that remains after making the deduction. It cannot be imagined, I think that the legislature by Section 26 (2) intended to deprive the person who suffered loss in his business of his right to get a set off under Section 24. Under Section 26 (2), if the Income-tax Officer is apprised of a succession to a business at the time of making the assessment the assessment shall be made on the person succeeding. This means that so far as that business is concerned, the assessment which was started against the transferor or predecessor, would end in an order of assessment upon the successor or transferee. But this can be done only when there is income, profit or gains from the particular business for which assessment is possible under Section (3), Income-tax Act. If there was no profit for the business in the year of accounting, Section 26 (2) of the Income-tax Act would not come into operation at all. No question of assessing the successor would then arise and the language of the section itself shows that the assessment is based on the assumption that the successor received the entire profits of the previous year. It is idle, in my opinion, to suggest that the successor may have other sources of income for which assessment might be possible; for the primary object of Section 26 (2) is not to allow set off to the successor, who in the ordinary course, might and ought to have been taxed on his other incomes. The object undoubtedly is to *assess* the successor on the *profits* of the business, which he is deemed constructively to carry on during the previous year, it being considered just or convenient by the legislature, that the tax should be recovered from him and not from his predecessor. Section 26 (2) has therefore in my opinion no application, when there is loss in the year of accounting in the business in respect to which succession has taken place, and there are no profits for which the successor could be taxed. To put any other construction, would lead to clear injustice. For various reasons, good or bad, the assessment proceedings might be delayed, and the assessee though he actually suffered loss in the business in the year of accounting would lose the privilege of a set off, for no fault of his. No

injustice however would result, if the business yielded profits. No question of claiming set off by the assessee would then arise and the successor on the other hand would get the benefit of a set off in respect of his losses on other heads of income. There will be thus no conflict between Sections 24 and 26 (2), and one of them would not exclude the other. The injustice is all the more palpable in a case like the present one, where the successor gets no corresponding advantage from which the predecessor is deprived. The succeeding companies in the present case, were brought into existence for the first time in 1934, and as they had no business at any time before, a claim of set off under Section 24 is of no advantage to them.

In the Madras case *Commissioner of Income-tax, Madras v. Messrs. Best & Co.*, no question of set off was raised, and the decision does not in any way militate against the view I have taken.

In *Bhogilal Hargovandas Patel v. Commissioner of Income Tax, Bombay*, which was decided by the Bombay High Court, the facts are undoubtedly distinguishable as the succession there took place within the year of accounting, but even then the observations of BEAUMONT, C.J., are rather in agreement with the opinion I have expressed above.

The observation is as follows :

"It is argued on behalf of the assessee that Section 26 (2) does not apply unless there are profits. There is no evidence that there were no profits and that therefore no assessment on the purchasing company was necessary; and in the absence of any evidence to that effect it seems to me that the Income-tax Officer was quite right in saying that the section applied."

BLACKWELL, J., undoubtedly took a different view, but I do not consider the reasoning to be sound.

Now, if we look at the matter from the standpoint of the transferee of the businesses it is clear that they cannot set off under Section 24, Income-tax Act, which allows set off to the assessee who suffers loss under any of the heads of his income. The transferees are, as I have said already, not the assesseees in the sense in which the word is used in Section 24 and cannot be said to have suffered any loss in the businesses, which in fact they have not carried on, and which they purchased after the year of assessment was over. There is no presumption under Section 26 (2) that they suffered loss in the businesses which they have purchased. Loss has been suffered by the undivided Hindu family

Messrs. B. K. Paul & Co., and they are the persons entitled to claim set off under Section 24.

For these reasons, I concur with my Lord the Chief Justice in holding that under the circumstances stated by the Commissioner, Messrs. B. K. Paul & Co. are entitled to claim set off in respect of the loss of businesses under Section 24, Income Tax Act, and this set off cannot be claimed by the succeeding companies to which these businesses were transferred.

Reference answered accordingly.

[IN THE PRIVY COUNCIL].

COMMISSIONER OF INCOME TAX, BOMBAY
PRESIDENCY & ADEN *v.* KHEMCHAND RAMDAS.

LORD WRIGHT, LORD ROMER, SIR LANCELOT SANDERSON,
SIR SHADI LAL and SIR GEORGE RANKIN.

April 7, 1938.

ASSESSMENT—FINAL ASSESSMENT AS REGISTERED FIRM—
CANCELLATION OF REGISTRATION BY COMMISSIONER IN REVISION
AND DIRECTION TO MAKE FRESH ASSESSMENT—FRESH ASSES-
SMENT TO SUPER TAX AFTER ONE YEAR—LEGALITY—LIMITATION
FOR EXERCISE OF POWERS UNDER SECTIONS 33, 34—ASSESSMENT
UNDER SECTION 23 (4) AS REGISTERED FIRM—REGISTRATION CAN-
CELLED—FRESH ASSESSMENT—APPEAL FROM ASSESSMENT—MAIN-
TAINABILITY—ORDER, WHETHER ONE UNDER SECTION 23 (4), 34
OR 35—COMPETENCY OF APPEAL & REFERENCE FROM BEST JUDG-
MENT ASSESSMENT—TESTS—‘ASSESSMENT’, MEANING OF—INDIAN
INCOME TAX ACT (XI OF 1922), SECTIONS 22 (2) & (4), 33, 34, 35,
58, 66 (2).

Though the Indian Income Tax Act nowhere imposes any limit of time within which an assessment under the provisions of Sections 23 and 29 is to be made and the service of notice of demand can therefore be made at any time, yet, after a final assessment under those sections has been made, the Income Tax Officer cannot go on making fresh computations and issuing fresh notices of demand to the end of all time. A final assessment once made cannot be re opened except in circumstances detailed in Sections 34 and 35 of the Act and within the time limited by those sections. The Commissioner's powers under Section 33 can only be exercised subject to the provisions of Sections 34 and 35. The provisions of these two sections are exhaustive

and prescribe the only circumstances in which and the only time in which such fresh assessments can be made and fresh notices of demand can be issued.

The mere fact that an assessment purports to have been made under Section 23 (4) does not shut out an appeal; it must be shown that the circumstances of the case bring it within the scope of that sub-section. If an order is really one under Section 34 or 35, an appeal would lie and the Commissioner could not by deciding that order is one under Section 23 (4) deprive the assessee of the right of having the question whether an appeal therefrom was competent decided by the High Court.

On January 17, 1927, the assessees were registered as a firm and they were assessed under Section 23 (4) on an income of Rs. 1,25,000 at the maximum rate. Being a registered firm no super-tax was levied. A notice of demand was also made before March 1927. On February 13, 1928, the Commissioner, in exercise of his powers under Section 33, cancelled the order registering the assessees as a firm and directed the Income Tax Officer to take necessary action. The Income-tax Officer accordingly assessed the firm to super-tax on May 4, 1929:

Held (i) that the assessment made on January 17, 1927, was final both in respect of income-tax and super-tax; the fresh action taken by the Income-tax Officer on May 4, 1929, was hopelessly out of time, though it was taken in pursuance of the directions of the Commissioner, and the order of May 4, 1929, was therefore one which the Income-tax Officer had no power to make;

(ii) that the order of May 4, 1929, could only be justified if at all as one made not under Section 23 (4), but under either Section 34 or Section 35; the Commissioner was in error when he quashed the appeal from that order on the ground that the order was one under Section 23 (4); the appeal raised a question of law whether the order was appealable; and the Commissioner was rightly directed to refer the case to the High Court.

The word, 'assessment' is used in Income-tax Acts as meaning sometimes the computation of income, sometimes the determination of the amount of tax payable, and sometimes the procedure laid down in the Act for imposing liability upon the tax-payer.

Section 23 (4), however, implies also the power to fix the sum payable as tax whatever the meaning of the word 'assessment' be.

Judgment of the Judicial Commissioner's Court of Sind reported as KHEMOCHAND RAMDAS V. COMMISSIONER OF INCOME TAX, BOMBAY (1934 I.T.R. 216; A.I.R. 1934 Sind 46; 149 I.C. 1204 affirmed)

Cases referred to—

DUNIOHAND *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1929] (I.L.R. 10 Lah. 596; A.I.R. 1929 Lah. 593).

RAJENDRANATH MUKHERJEE *v.* COMMISSIONER OF INCOME TAX, BENGAL [1934] (I.L.R. 61 Cal. 285; 61 I.A. 10; 147 I.C. 663; 1934 I.T.R. 71; 7 I.T.C. 143).

Appeal from a Judgment of the Judicial Commissioner's Court of Sind [P. C. Appeal No. 63 of 1937]. The Judgment appealed from is reported at 1934 I.T.R. 216 *q. v.*

J. Millard Tucker, K. C., and W. Wallach for the Appellant.

J. M. Pringle for the Respondents.

JUDGMENT.

LORD ROMER.—The respondents to this appeal are a firm who carry on business at Bunder Abbas and Kerman outside British India but are assessable to taxation in respect of their income under the provisions of the Indian Income-tax Act, 1922. Their total income during the fiscal year ending on March 31, 1926, being in the opinion of the Income-tax Officer, Shikarpur, of such an amount as to render them liable to income tax under that Act for the year ending March 31, 1927, a notice was served upon them by that official in accordance with the provisions of Section 22 (2) requiring them to make a return of that income. He also served upon them a notice under sub-section (4) of the same section requiring production of the relevant accounts and documents. Had the respondents thought fit to comply with these notices, they would have avoided a good many of the difficulties in which they subsequently found themselves involved. Unfortunately they completely ignored the notices. The duty of the Income-tax Officer in such circumstances is prescribed by Section 23 (4) of the Act. It is to "make the assessment to the best of his judgment." One of the peculiarities of most Income-tax Acts is that the word "assessment" is used as meaning sometimes the computation of income sometimes the determination of the amount of tax payable and sometimes the whole procedure laid down in the Act for imposing liability upon the tax-payer. The Indian Income-tax Act is no exception in this respect, and some discussion took place before their Lordships as to the meaning of the words "make the assessment" in Section 23 (4), the question debated being whether the words mean no more than "compute the total income" or whether they include also the determination of the tax payable. It was pointed out that by sub-section (1) of the same section, which deals with the cases where the officer is satisfied with the

return made by the tax-payer, the officer is in terms directed both to assess total income and to determine the sum payable on the basis of such return. So, too, under sub-section (3), which deals with the cases where the officer is not satisfied that the return is correct or complete. In such cases the sub-section requires that the officer, after hearing evidence as therein mentioned shall "assess the total income of the assessee and determine the sum payable by him on the basis of such assessment." Sub-section (4) on the other hand merely directs the officer to "make the assessment to the best of his judgment" and contains no specific reference to a determination by him of the sum payable. Unless, therefore, the word "assessment" in sub-section (4) is intended to mean something more than the word means in sub-sections (1) and (3) (and it may be observed that this is by no means improbable in an Income Tax Act), the officer is not in terms given any power to determine the sum payable by the tax payer. Their Lordships do not find it necessary to express any opinion upon this question, which seems to them to be, merely one of academic interest. For even if such a power be not given expressly by the direction to "make the assessment," it is, in their opinion, plainly implied, reading the section as a whole. And this view is strongly corroborated by Section 29, which is in these terms :—

"When the Income-tax Officer has determined a sum to be payable by an assessee under Section 23.....the Income-tax Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum so payable."

Now the prescribed form in terms applies to an assessment under Section 23 (4).

In the present case the officer in due course acted under the sub-section and made an assessment to the best of his judgment, and at the same time or shortly afterwards served upon the respondents a notice of demand under Section 29. But before dealing further with such assessment and demand it is necessary to refer to some other provisions of the Act and the rules made thereunder.

By Section 55 of the Act it is provided as follows :—

"In addition to the income-tax charged for any year there shall be charged, levied and paid for that year in respect of the total income of the previous year of any individual, Hindu undivided family, company, unregistered firm or other association of individuals, not being a registered firm, an additional duty of

income-tax (in this Act referred to as super-tax) at the rate or rates laid down for that year by Act of the Indian Legislature."

By virtue of Section 56 the total income of an unregistered firm is for the purposes of super-tax the total income as assessed for the purposes of income tax, and an assessment (which here must mean a computation) of total income that has become final and conclusive for the purposes of income-tax is made final and conclusive for the purposes of super-tax for the same year.

By Section 58 all the provisions of the Act (with certain exceptions not material for the present purpose) are made applicable so far as may be to the charge, assessment, collection and recovery of super-tax.

By Section 2 (4) the words "registered firm" are defined as meaning a firm constituted as therein mentioned of which the prescribed particulars have been registered with the Income-tax Officer in the prescribed manner.

On May 18, 1926, the respondents applied to the Income-tax Officer for registration and such registration was effected by him on January 17, 1927.

It is now necessary to return to the "assessment" made by the Income-tax Officer under Section 23 (4) and the notice of demand served by him upon the respondents under Section 29.

The assessment is dated January 17, 1927 (the same date it may be noticed as that on which the registration of the respondents was effected) and so far as material is in the following terms:—

"The assessee has failed to return form I.

In spite of several appointments having been given, he has failed to produce Bunder Abbas account in Shikarpur books. He is accordingly assessed on enquiries on an income of Rs. 1,25,000 at the maximum rate."

"The firm having applied for registration is registered, therefore, no super-tax is levied."

Their Lordships have no information either as to the terms of the notice of demand under Section 29 following upon this assessment or as to the precise date upon which it was served upon the respondents. It would seem, however, that it was served not later than the month of March 1927.

After service of that notice the Income-tax Officer had done all that was required of him under the Act for the purposes of ascertaining the liability of the respondents to income tax and

super-tax for the fiscal year ending on March 31, 1927. So far, too, as the respondents were concerned, their assessment for the year (using the word assessment in its most comprehensive sense) had become final and conclusive. For though by Section 30 (1) a right of appeal to the Assistant Commissioner is given to an assessee objecting to the amount or rate at which he is assessed under Section 23 or denying his liability to be assessed under the Act, the sub-section contains a proviso to the effect that no appeal shall lie in respect of an assessment made under Section 23 (4). If, however, the respondents concluded from all this that after payment of the sum mentioned in the notice of demand all their taxation troubles for that year were ended, they were reckoning without the Commissioner of Income-tax and the powers conferred upon that functionary under Section 33 of the Act. That section so far as material for the present purpose, is as follows :

"(1) The Commissioner may, of his own motion, call for the record of any proceeding under this Act which has been taken by any authority subordinate to him....."

"(2) On receipt of the record the Commissioner may make such inquiry or cause such inquiry to be made and, subject to the provisions of this Act, may pass such orders thereon as he thinks fit :

Provided that he shall not pass any order prejudicial to an assessee without hearing him or giving him a reasonable opportunity of being heard."

The circumstances in which in the present case the Commissioner exercised or purported to exercise the powers conferred upon him by the section have been described by him in the following words :

"In January, 1928, it was brought to the notice of the Commissioner of Income-tax that the deed of partnership produced by the firm for the purposes of its registration was not a valid deed of partnership and that, therefore, the order granting registration was not correct. Hence a notice under Section 33 of the Act was issued to the firm on January 9, 1928, calling upon it to show cause why the Income-tax Officer's order of January 17, 1927, registering the firm be not set aside. The firm thereupon sent a written representation and after considering it, the Commissioner, in virtue of his powers under Section 33 of the Act, revised on February 13, 1928, the Income-tax Officer's order regarding registration of the firm and ordered its cancellation, directing the Income-tax Officer to take the necessary action thereupon."

It is by no means certain that the Commissioner came to a correct conclusion regarding the invalidity of the registration of the respondents. But as the law stood at that time, no appeal lay from an order made by the Commissioner under Section 33 and it must be taken that the order cancelling the registration was properly made. Nor is it at all certain that such order could operate retrospectively so as to affect the respondents' liability to super-tax for the year 1927-28. It has, however, been conceded by the respondents in effect that by reason of such order they must be treated as having been an unregistered firm during the fiscal year in question and could have been charged with super-tax for that year had the proper steps been taken for that purpose. Their Lordships are willing to deal with the case on the footing of such concession without expressing any opinion upon the question whether the concession was rightly made. The real question between the parties is whether the action taken by the Income-tax Officer consequent upon the Commissioner's order of cancellation has been effectual to charge the respondents with such super-tax.

What he in fact did was to issue an order dated May 4, 1929, which (so far as material) is in the following terms :

"The firm was originally assessed to income-tax on an income of Rs. 1,25,000 as a registered firm. The registration order was subsequently cancelled. The firm is accordingly assessed to super-tax on Rs. 1,25,000 less Rs. 50,000. Issue N. D. accordingly for super-tax of Rs. 5,468-12-0."

The N. D. (notice of demand) was served upon the respondents three days later.

It is to be observed that the order was issued more than one year after the close of the fiscal year ending on March 31, 1927, and more than one year after the date of the earlier demand to which reference has already been made. The significance of this fact will appear presently. It should be added that the respondents in no way challenged the figures contained in the order of May 4, 1929. What they did challenge was the power of the Income-tax Officer to make the order at all. Accordingly on June 4, 1929, they appealed to the Assistant Commissioner under Section 30 (1) asking that the order might be set aside. It is clear from the Commissioner's statement cited above that the Income-tax Officer in making the order complained of was acting in pursuance of the directions given to him by the Commissioner under Section 33; and at that time, as has already been stated, no

appeal could be brought against an order made under that section. But no such order can be made that is inconsistent with the other provisions of the Act. One of the questions, therefore, arising upon the appeal, was whether the Income-tax Officer had any power to make the order apart from the direction given to him by the Commissioner. If he had not, the fact that such direction was given was an irrelevant circumstance. Another question arising upon the appeal was as to its competency. Having regard to Section 58 (1) of the Act, the provisions contained in Section 30 (1) giving a right to appeal to the Assistant Commissioner in the case of an assessee denying his liability to be "assessed under the Act", which must mean in that context "charged with tax under the Act," is as applicable to super-tax as it is to ordinary income-tax. But the proviso to that sub section has to be considered. If the order of May 4, 1929, can properly be described as an assessment under Section 23 (4) no appeal would lie.

This appeal came on for hearing on April 12, 1930, and was dismissed by the Assistant Commissioner upon its merits. He did not deal with the question of the competency of the appeal. He merely held that the order of May 4, 1929, was valid, and he confirmed the tax. In so doing, he must have been acting under the powers given to him by Sec. 31 (3) (a) which is in these terms :—

"In disposing of an appeal the Assistant Commissioner may in the case of an order of assessment :—

(a) confirm, reduce, enhance, or annul the assessment.

* * *

In confirming the tax, therefore, the Assistant Commissioner must have regarded the order as an assessment within the meaning of the sub-section, as indeed it was. But he expressed no opinion upon the question whether such assessment was one made under Section 23 (4).

Following upon the dismissal of their appeal the respondents then applied to the Commissioner himself, asking him to exercise his powers under Section 33 and set aside both the order of the Income-tax Officer "levying super-tax" and the order of the Assistant Commissioner that confirmed such tax. Inasmuch as the Income-tax Officer in "levying super-tax" had merely acted in pursuance of the directions given by the Commissioner, the respondents could not have felt too certain of success. So they asked him in the alternative to refer the matter to the High Court under the provisions of Section 66 (2) of the Act. That sub-section is, or rather was at that time, as follows :—

"(2) Within one month of the passing of an order under Section 31.....the assessee in respect of whom the order was passed may by application.....require the Commissioner to refer to the High Court any question of law arising out of such order and the Commissioner shall within one month of the receipt of such application draw up a statement of the case and refer it with his own opinion thereon to the High Court".

Sub-section (3) of the same section ran as follows:—

"(3) If, on any application being made under sub-section (2) the Commissioner refuses to state the case on the ground that no question of law arises, the assessee may.....apply to the High Court, and the High Court, if it is not satisfied with the correctness of the Commissioner's decision, may require the Commissioner to state the case, and to refer it, and, on receipt of any such requisition, the Commissioner shall state and refer the case accordingly".

The application to the Commissioner to set aside the order of the Income-tax Officer was rejected by the Commissioner as was the application to state a case. He regarded the case as a clear one of assessment under Section 23 (4) in respect of which no appeal would lie. The appellate proceedings before the Assistant Commissioner and the appellate order were, therefore, in his opinion illegal. "Hence," said he, "I quash them under Section 33 of the Act". The proceedings having been quashed, there was, in his view, no order out of which any questions of law could arise and nothing, therefore, that could be referred to the High Court under Section 66 (2). He accordingly refused to state a case.

In their Lordships' opinion the Commissioner was plainly wrong in so doing. One of the questions of law arising out of the order of the Assistant Commissioner was whether the appeal to him was competent in view of the proviso to Section 30 (1). By deciding the question himself adversely to the respondents, the Commissioner could not deprive the respondents of the right of having the question decided by the Court. This was the view of the matter rightly taken by the Court, who upon application made to them by the respondents under Section 66 (3) ordered the Commissioner to state a case and refer it to them for their decision.

The Commissioner accordingly drew up a statement of the case and referred it with his own opinion thereon to the Court, setting out in the statement at some length his reasons for thinking that he ought never to have been ordered to do so.

The case in due course came on for hearing before Additional Judicial Commissioners Aston and Rupchand Bilaram on January

22, 1934. Their decision was in favour of the respondents. The Commissioner then applied for and obtained from the High Court a certificate that the case was a fit one for granting leave to appeal to His Majesty in Council. The present appeal was thereupon lodged.

At the hearing before the Additional Judicial Commissioners, the arguments would appear to have covered a wide range and to have raised a number of interesting and important questions of law. Their Lordships do not, however, find it necessary to consider all these questions. It is in their opinion sufficient to dispose of this appeal if the two questions to which they have already called attention be decided, as in their Lordships' opinion they should be decided, in favour of the respondents. These two questions are : (1) was the appeal to the Assistant Commissioner from the order of May 4, 1929, competent? (2) Had the Income-tax Officer any power to make that order in view of the provisions of Sections 34 and 35 of the Act to which reference will presently be made?

These two questions are so closely related to one another that they can conveniently be considered together.

In order to answer them, it is essential to bear in mind the method prescribed by the Act making an assessment to tax, using the word assessment in its comprehensive sense as including the whole procedure for imposing liability upon the tax payer. The method consists of the following steps. In the first place the taxable income of the tax-payer has to be computed. In the next place the sum payable by him on the basis of such computation has to be determined. Finally a notice of demand in the prescribed form specifying the sum so payable has to be served upon the tax payer. The second of these steps involves the determination of two sums namely, the sum payable for income-tax and the sum payable for super-tax. The notice of demand in the prescribed form also provides for the sums payable for income-tax and super tax being specified separately. Considerable discussion accordingly took place before the High Court on the question whether a demand for super-tax in order to be valid ought to be made simultaneously with the demand for income-tax. Aston, A.J.C., considered that the demand for super-tax should be made within a reasonable time of the assessment for income-tax, meaning no doubt, by assessment the service of the notice of demand for income-tax which normally completes the assessment. Rupchand Bilaram, A.J.C., was of opinion, that the demand for super-tax should be made within a reasonable time, and, therefore, almost simultaneously

with the demand for income-tax. Both of them held for this reason (amongst others) that the service of the Notice of Demand of May 4, 1929, was illegal and inoperative to impose liability upon the respondents. Their Lordships do not find it necessary to express any opinion upon this point inasmuch as in their view and for the reasons which they will now proceed to give it does not call for determination in the present case.

It had been argued on behalf the appellant that the Act nowhere imposes any limit of time within which an assessment under the provisions of Sections 23 and 29 is to be made, and that the service of the notice of demand can, therefore, be made at any time. This is true. It had, in effect, been so determined by this Board in the case of *Rajendra Nath Mukherjee v. Income-tax Commissioner*. But it is not true that after a final assessment under those sections has been made, the Income-tax Officer can go on making fresh computations and issuing fresh notices of demand to the end of all time.

It is possible that the final assessment may not be made until some years after the close of the fiscal year. Questions of difficulty may arise and cause considerable delay. Proceedings may be taken by way of appeal and cause further delay. Until all such questions are determined and all such proceedings have come to an end, there can be no final assessment. But when once a final assessment is arrived at, it cannot in their Lordships' opinion be re-opened except in the circumstances detailed in Sections 34 and 35 of the Act (to which reference is made hereafter) and within the time limited by those sections. In the present case the liability of the respondents both for income-tax and for super-tax was determined by the Income-tax Officer on January 17, 1927. In the order made by him on that date he assessed the respondents to income-tax at the maximum rate but as the respondents were at that time a registered firm, he held, as he was bound to hold, that no super-tax was to be levied. On some date before the end of March 1927 he served on the respondents a notice of demand for the tax that he had determined was properly leviable. The assessment having been made under Section 23 (4) no appeal lay in respect of it. The assessment of the respondents was, therefore, final both in respect of income-tax and super-tax. Their liability in respect of both taxes had been finally determined and none the less because the question of their liability to super-tax had been determined in their favour. It was, indeed, contended before their Lordships

that the assessment could not be regarded as having been determined inasmuch as the Commissioner might at any time, and apparently after any lapse of time, however long, cancel the registration of the respondents as a registered firm and so subject the respondents to liability to pay super-tax. Their Lordships would, in any case, hesitate long before acceding to a contention that would lead to so extravagant results. In their opinion, however, the contention cannot prevail. The Commissioner's powers under Section 33, can only be exercised subject to the provisions of the Act of which the provisions in Sections 34 and 35, are in this respect of the greatest importance. These sections are or were at the material time as follows :

" 34. If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year, or has been assessed at too low a rate, the Income-tax Officer may at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains, or, in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of Section 22 and may proceed to assess or re-assess such income, profits or gains, and the provisions of this Act shall, so far as may be, apply accordingly as if the notice were a notice issued under that sub-section :

Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be. :

35. (1) The Income-tax Officer may, at any time within one year from the date of any demand made upon an assessee, on his own motion rectify any mistake apparent from the record of the assessment, and shall within the like period rectify any such mistake which has been brought to his notice by such assessee :

Provided that no such rectification shall be made, having the effect of enhancing an assessment unless the Income-tax Officer has given notice to the assessee of his intention so to do and has allowed him a reasonable opportunity of being heard.

(2) Where any such rectification has the effect of reducing the assessment, the Income-tax Officer shall make any refund which may be due to such assessee.

(3) Where any such rectification has the effect of enhancing the assessment, the Income-tax Officer shall serve on the assessee a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to be issued

under Section 29, and the provisions of this Act shall apply accordingly."

In view of these express provisions of the Act, it is in their Lordships' opinion quite impossible to suppose that the Income-tax Officer may in every kind of circumstance and after any lapse of time make fresh assessments or issue fresh notices of demand; or that the Commissioner can direct him so to do. In their Lordships' opinion the provisions of the two sections are exhaustive, and prescribe the only circumstances in which and the only time in which such fresh assessments can be made and fresh notices of demand can be issued. In the present case it is a debatable question whether the circumstances were such as to bring it within the provisions of Section 34. It is not necessary to determine that question inasmuch as, in their Lordships' opinion, the case clearly would have fallen within the provisions of Section 35 had the Income-tax Officer exercised his powers under the section within one year from the date on which the earlier demand was served upon the respondents. For, looking at the record of the assessments made upon them as it stood after the cancellation of the respondents' registration—and the order effecting the cancellation would have formed part of that record—it would be apparent that a mistake had been made in stating that no super-tax was leviable. The Income-tax Officer took no further step, however, until May, 1929, and by then he was hopelessly out of time whichever of the two sections was applicable.

Their Lordships are accordingly of opinion that the order of May 4, 1929, was one that the Income-tax Officer had no power to make, and that the second of the two questions to which they have referred must be answered in the affirmative. For the order could only be justified, if at all, as one made, not under Section 23 (4) but under either Section 34 or Section 35. If it was made as the Commissioner has found, in purported exercise of the powers given by Section 23 (4) the assessee nevertheless had a right of appeal to the Assistant Commissioner under Section 33 and the Commissioner was in error when he quashed the proceedings on that appeal. For, as was truly said by SIR SHADI LAL in the case of *Duni Chand v. Commissioner of Income-tax* at p. 601,

"The mere fact that the assessment purports to have been made under that sub-section does not shut out the appeal; it must be shown that the circumstances of the case bring it within the scope of that sub-section,"

For these reasons, which do not differ substantially from the opinions expressed by the Court of the Judicial Commissioner, their Lordships are of opinion that the appeal should be dismissed with costs.

They will humbly advise His Majesty accordingly.

Appeal dismissed.

[IN THE BOMBAY HIGH COURT].

COMMISSIONER OF INCOME TAX, BOMBAY
PRESIDENCY, SIND AND BALUCHISTAN

v.

THE GRAIN MERCHANTS' ASSOCIATION OF BOMBAY.

SIR J. W. F. BEAUMONT, C. J. and KANIA, J.

March 23, 1938.

EXEMPTION—CHARITABLE INSTITUTIONS—'OBJECT OF GENERAL PUBLIC UTILITY', MEANING OF—BENEFIT CONFINED TO A SECTION OF PUBLIC, *viz.*, PEOPLE INTERESTED IN COMMERCE—WHETHER ONE OF GENERAL PUBLIC UTILITY—INTEREST INCOME—ALLOWANCES—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 4 (3) (i) & (ii), 12 (2).

The expression 'object of general public utility' in Section 4 (3) of the Indian Income Tax Act means an object of public utility which is available to the general public as distinct from any section of the public.

The income of the Bombay Grain Merchants' Association was to be spent 'as per the resolutions of the Committee of the Association passed from time to time on matters of commercial and other small as well as big works of public utility': Held, that the object of the association was not an object of general public utility within the meaning of Section 4 (3) as it was confined to a section of the public i.e., those interested in commerce, and the income of the association was not exempt from tax under that clause. Held further, that as against the income of the association from interest subjected to tax, only such expenditure as was incurred solely for the purposes of earning it was allowable under Section 12 (2) of the Income Tax Act.

Reference made by the Commissioner of Income Tax, Bombay, under Section 66 (2) of the Indian Income Tax Act, XI of 1922,

referring for the decision of the High Court a statement of a case involving certain points of law.

The Statement of the Case was as follows :—

“ Under Section 66 (2) of the Indian Income Tax Act, XI of 1922 (hereinafter referred to as “ the Act ”), and at the instance of the Grain Merchants’ Association of Bombay (hereinafter referred to as “ the Association ”), I have the honour to refer for your Lordships’ decision, the questions of law set out in paragraph 8 below, which have arisen out of the income-tax assessment of the Association for the financial year 1934-35, ended on the 31st March 1935.

2. **Facts of the Case.**—The Association is formed for the purpose (*inter alia*) of promoting and safeguarding the trade of grain, seeds, spices, gum, oilcakes and other raw materials produced in India, with local and foreign markets. The aims and objects of the Association are set out in paragraph 4 of its Constitution. As these are in the Gujarati language, a translation thereof into English was supplied by the Secretary of the Association. Some of the relevant clauses of the said paragraph are as under :—

“ (a) To promote trade of grain, seeds, spices, gum, oilcakes and other raw materials produced in India, with local and foreign markets. To safeguard its general interests, to remove difficulties experienced therein and to do all that is necessary for the welfare of the institution and its members by every means.

“ (b) To frame rules and regulations pertaining to the said trade and to amend and execute the same.

“ (c) To arbitrate and decide disputes arising amongst members of the Association *inter se* and also between members and other parties who have dealings with them.

“ (d) To decide disputes relating to the said trade taking into consideration the customs and usages (of trade).

“ (e) To co-operate if necessary with other commercial bodies and institutions for the avowed objects of the Institution.

“ (f) To communicate with Government, Railways, Municipality, Port Trust and other public departments with a view to safeguard and protect the general interest of the trade by every possible means.

“ (g) To raise funds by levying cess for charitable purposes of objects of general public utility and to manage them.

“ (h) To collect, classify and disseminate information relating to trade and promoting the objects of the Association and to

propagate commercial, industrial and economic knowledge amongst members by suitable means.

"(j) To arrange for imparting commercial and industrial education".

Other paragraphs relevant to this reference are the following :

"14 (a) Each member shall pay subscription to the Association at the rate of one anna per 100 bags on actual deliveries of the goods sold on Bazar Dhara or delivery Dhara.

"(b) Every new member shall pay Rs. 25 as annual subscription and Rs. 51 as admission fees with the application and the same being sanctioned by the Managing Committee he shall be enlisted as an associate member.

"(c) Those who have become members according to clause (b) above shall pay cess as shown in clause (a) on the actual delivery of the goods sold by them but if such a cess does not amount to 8,000 bags during the year they shall have to again apply as per clause (b) (for becoming member next year) but no admission fees will be taken from them. But once their names are removed, fresh admission fees shall have to be paid".

After the Association was called upon to submit its return of income, the following additional paragraph 41 was added by a Resolution passed on 6th June 1936 :—

"41. As to the income that is received and will be received from the members of this Association on account of the Lagas and fees and other miscellaneous items except those relating to Dharmada (charity), whatever amount is collected and will be collected thereby, after deducting therefrom all the expenses of the Association relating thereto, is being spent and will be spent as per Resolutions of the Committee of the Association passed from time to time in matters of commercial and other small as well as big works of public utility. In other words, any portion out of this amount and any interest thereon has not been hitherto spent for the personal benefit of any member of this Association and the savings out of the income on account of these Lagas, fees and other miscellaneous items and the interest thereon will not even hereafter be spent for the personal benefit of any member of this Association. But whatever will be left of such saved moneys and the interest realised thereon after deducting therefrom all the expenses of the Association relating thereto will be spent for such commercial and other small and big works of public utility as may be resolved upon by the Committee of the Association from time to time".

3. The income of the Association is derived from the following sources in addition to the fees, annual subscriptions and cess collected from the members :—

- (i) Certified Brokers' fees.
- (ii) Fees for writing letters.
- (iii) Weighing fees.
- (iv) Letter and Hundi delivery fees.
- (v) Penalty for trading on holidays.
- (vi) Railway Survey fees.
- (vii) Goods Landing charges.
- (viii) Delivery and Contract books account.
- (ix) Interest on loans and mortgages.

4. For the assessment year 1934-35, the Income Tax Officer, B Ward, Section II, Bombay, issued to the Association a notice under Section 22 (2) of the Act calling for a return of income and in pursuance thereof, it put in its return declaring a deficit of Rs. 1,819 for the Samvat year 1989 which was the " previous year " within the meaning of Section 2 (11) of the Act, for the purposes of the aforesaid assessment. The Income Tax Officer, thereupon, after hearing the Association and after due consideration of the accounts put in, assessed the assessee on an income of Rs. 9,390, by his order dated 10th October 1936, a copy of which is annexed hereto and marked Exhibit A. It was contended before the said officer that receipts from none of the items referred to above except No. (ix), viz., Interest on loans and mortgages, were liable to tax and the Income Tax Officer accepted that contention. The Association, however, claimed that its total expenditure amounting to Rs. 13,347 should be set off against the said interest income which amounted to Rs. 12,020. The Officer, however, held that the only deduction allowable was in respect of interest credited to the accounts of several charitable funds separately maintained by the Association which amounted to Rs. 2,424. He also allowed sundry expenses to the extent of Rs. 206 holding that that much amount must have been spent in collecting the income from interest.

5. The Association was not satisfied with the Income Tax Officer's decision and appealed against the assessment to the Assistant Commissioner of Income Tax, B Division, Bombay, under Section 30 of the Act on the following among other grounds :—

(1) by reason of the provision in the rules and regulations of the Association to the effect that the surplus on hand including the interest earned after deducting expenses was to be utilized

towards the commercial advancement and objects of general public welfare, the Association was exempt from taxation ;

(2) though the investment of the surplus funds brought some income, yet as there was a strict rule not to use the income towards any personal gain of any of the members of the Association the income was exempt under Section 4 (3) (ii) of the Act ; and

(3) the Income-tax Officer should have allowed all the expenses against the interest income and accepted the deficit declared in the return of income put in by the Association.

6. The Assistant Commissioner heard the appeal and held that the income of the Association could not be said to be derived from property held in trust or other legal obligation wholly for religious or charitable purposes and that therefore Section 4 (3) (i) of the Act did not apply. He also held that the said income could not also be said to be the income of a religious or charitable institution derived from voluntary contributions and applicable solely to religious or charitable purposes as contemplated in Section 4 (3) (ii) of the Act. Regarding the expenditure claimed, he held that the expenditure shown in the profit and loss statement represented all the outgoings of the Association as against receipts of *all* kinds earned by it, and that in order to earn the interest income assessed to tax an expenditure of Rs. 25 per mensem ought to suffice. He allowed therefore a sum of Rs. 300 instead of Rs. 206 allowed by the Income-tax Officer and reduced the income liable to tax to Rs. 9,296. A copy of the order dated 19th December 1936 passed under Section 31 of the Act is annexed hereto, marked Exhibit B.

7. Being dissatisfied with the above decision, the Association has applied under Section 66 (2) of the Act requesting that its case be referred to this Honourable Court. A copy of its application is annexed hereto, marked Exhibit C.

8. **Questions of law for decision of the Honourable Court.**—I submit for favour of decision the following questions :—

(1) Under the circumstances of the case, has the Assistant Commissioner rightly held that the Association was not entitled to exemption from tax under the provisions of Section 4 (3) (i) and (ii) of the Act ?

(2) In case the answer to the above question be in the affirmative, has the Assistant Commissioner rightly held that as against the income from interest subjected to tax, only such expenditure as was incurred solely for the purposes of earning it was allowable under Section 12 (2) of the Act ?

9. **Opinion of the Commissioner.**—As Section 66 (2) of the Act requires me to give my opinion while submitting this Statement of the Case, I beg to state that the answer to the first question should, in my respectful opinion, be in the affirmative. Admittedly the funds from which the said income from interest arises are not “property held under trust or other legal obligation wholly for religious or charitable purposes” within the meaning of Section 4 (3) (i) of the Act. There are certain accounts in the books of the association which pertain to certain charities and interest credited to these accounts has been already exempted. As regards the remaining interest, it is not derived from money held under any trust or legal obligation for any charitable purpose. Paragraph 41 of the Constitution of the Association quoted above says that the income is to be spent “in matters of commercial and other small as well as big works of public utility. These are vague words and I submit that “matters of commercial utility” cannot be “charitable purposes” within the meaning of Section 4 (3) (i) of the Act for, as stated at the end of the section, a charitable purpose “includes relief of the poor, education, medical relief and the advancement of any other object of general public utility”. Advancement of commerce benefits only the particular commercial community concerned and not the *general* public.

I further submit that Section 4 (3) (ii) does not apply as the Association is an ordinary trade association and is in no sense “a religious or charitable institution,” nor is the income derived “from voluntary contributions”. The Association further appears to hold the view that because the money which has been invested is derived from subscriptions from members and other receipts of the Association which are not held liable to tax, the income from the investment thereof is also to be exempted. It is submitted it is quite immaterial for the purposes of taxation to consider the source from which the money invested in loans and mortgages was derived. If money from whatever source derived is lent out at interest, the income arising therefrom is liable to tax.

10. As regards question (2), the income of the Association from interest which has been subjected to tax has to be computed as laid down in Section 12 of the Act and under sub-section (2) thereof “Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains, provided that no allowance shall be made on account of any personal expenses of the assessee”. It

appears clear that only the expenditure incurred solely for the purpose of earning this interest income is allowable.

11. A copy of your Lordship's decision may kindly be certified to me for further action as required by Section 66 (5) of the Act".

The Advocate General with the *Government Solicitor* for the Commissioner of Income Tax.

Taraporewalla with *Messrs. Malvi Ranchhoddas & Co.* for the assessees.

JUDGMENT.

BEAUMONT, C.J.—This is a reference by the Commissioner of Income-tax under Section 66 (2) of the Indian Income-tax Act raising a point of no great difficulty. The assessees are the Grain Merchants' Association of Bombay and they had put in their return declaring a deficit of Rs. 1819. Their income, material for the present purpose, consists of interest earned on investments. Admittedly that source of income is liable to tax but the assessee Association say that they are not liable since they fall within the exemption contained in Section 4 (3) of the Act. That section provides that tax is not payable in respect of any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes. Then there is a proviso to it to the effect that in this sub-section "charitable purpose" includes relief to the poor, education, medical relief, and the advancement of any other object of general public utility. The assessees have passed a resolution, in point of fact after the date of the order of assessment, though we are told, that it only declares what was their previous custom, which provides that the income which is now in question will be spent as per the resolutions of the Committee of the Association passed from time to time on matters of commercial and other small as well as big works of public utility. The only real question is whether these words fall within the words of the proviso to Section 4 (3) *viz.*, "general public utility". In my opinion an object of general public utility means an object of public utility which is available to the general public as distinct from any section of the public; and the objects of this association are clearly, to my mind, to benefit works of public utility confined to a section of the public, *i.e.*, those interested in commerce. I think, therefore that the assessees do not bring themselves within the exemption contained in Section 4 (3) and that the answer to the first question must, therefore, be in the affirmative. The second question also will be answered in the affirmative.

KANIA, J.—I agree.

Per Curiam :—Assessee to pay the costs of the Commissioner of Income-tax taxed on the original side scale less one hundred rupees.

[IN THE ALLAHABAD HIGH COURT].

MAJOR A. U. JOHN *In re*.

SIR JOHN THOM, C.J., HARRIES, J., and BAJPAI, J.

April 25, 1938.

INCOME—MEANING OF 'INCOME'—NECESSITY OF ELEMENT OF PERIODICAL RECEIPT—DEFINITION IN *Shaw Wallace's Case*—COURT SALE—DECREE HOLDER ALLOWED TO ACT AS AUCTIONEER AND TO SET OFF 5 PER CENT AS COMMISSION AGAINST POUNDAGE FEE OF $6\frac{1}{2}$ PER CENT—COMMISSION SO ADJUSTED, WHETHER 'INCOME'—ASSESSABILITY—CASUAL AND NON-RECURRING RECEIPT NOT ARISING FROM BUSINESS—EXEMPTION—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 4 (1), 4 (3) (vii).

The element of periodical receipt or regularity or expected regularity of monetary return is an essential ingredient of 'income' under the Indian Income Tax Act. The observations made by the Privy Council on the nature of 'income' in Shaw Wallace & Co.'s Case were not intended to be confined to the particular facts of that case but were intended to lay down for the guidance of the Courts of India some general principle on the question as to what can be treated as income under the Act.

Gaya Prasad & Chotey Lal, *In re*, (1935 I.T.R. 177) dissented from.

The assessee, one Major John, held 40 lacs and his brother held 10 lacs of a total of 50 lacs of debentures of a company. The assets of the company were sold in execution of a decree obtained on the debentures and knocked down for a sum of Rs. 20,80,000 and this sum was set off against the decretal amount. Under the rules of the Court the auction purchaser had to pay $6\frac{1}{2}$ per cent as poundage and if a person other than the Amin of the Court acted as auctioneer he was entitled to commission of 5 per cent. The assessee was permitted by the Court to act as auctioneer and was allowed to deduct 5 per cent from the $6\frac{1}{2}$ per cent which he had to pay to the Court. The Income Tax authorities treated this 5 per cent commission which amounted to Rs. 1,04,000 as income of the assessee and levied income tax on it.

Held, on a reference by the Commissioner: (i) that the sum of Rs. 1,04,000 was not 'income' within the meaning of the Income-tax Act; there was in fact no receipt at all but the granting of a mere relief; (ii) even if the assessee be regarded as having received this sum, the receipt was not one arising from business or the exercise of a profession or vocation and was of a casual and non-recurring nature and was therefore exempt from income-tax under Section 4 (3) (vii) of the Act.

Cases referred to :

COMMISSIONER OF INCOME TAX, BENGAL *v.* SHAW WALLACE & Co. [1932] (59 I.A. 206; 136 I.C. 742; 36 C.W.N. 653; 84 Bom. L.R. 1033; 63 M.L.J. 124; A.I.R. 1932 P.C. 138; 1932 Comp. Cas. 276; 59 Cal. 1343).

GAYA PRASAD & CHOTTEY LAL *In re* [1935] (8 I.T.C. 64; 1935 I.T.R. 177; 1935 A.L.J. 405; 154 I.C. 963; A.I.R. 1935 All. 495).

MAHARAJ KUMAR GOPAL SARAN NARAIN SINGH *v.* COMMISSIONER OF INCOME TAX, BIHAR & ORISSA [1935] (8 I.T.C. 340; 1935 I.T.R. 237; 39 C.W.N. 1093; 1935 A.L.J. 925).

STATEMENT OF CASE.

Case stated by the Commissioner of Income-tax, Central and United Provinces, under Section 66 (2) of the Income-tax Act (XI of 1922, hereinafter referred to as the Act) at the instance of Major A. U. John of 49, Cantonment, Agra (an individual within the meaning of Section 3 of the Act, hereinafter referred to as the assessee) for favour of decision by the Hon'ble the High Court of Allahabad of the questions of law set out in paragraph 4 below arising out of the appellate decision of the Assistant Commissioner of Income-tax, Meerut, in the matter of the assessment of the above assessee for the financial year 1932-33 ended on 31st March 1933. A copy of the application for reference under Section 66 (2) of the Act is annexed hereto as Appendix A.

2. **Facts of the Case.**—The assessee was a partner in the defunct firm of Messrs. A. John & Co., which owned three spinning mills and one flour mill at Agra. In the year 1920 the firm sold all the four mills to a company styled the Agra United Mills Ltd., for a sum exceeding a crore of rupees. Part of the Consideration was paid by the company in mortgage debentures of the value of Rs. 50,00,000 issued in favour of the following persons :

	Rs.
(1) The assessee	... 30,00,000
(2) Mr. G. A. John	... 10,00,000

(3) Sir Edwin John, Kt., Morar, } in the Gwalior State	5,00,000
(4) Mr. H. C. John of London	
(5) The National Bank of India Ltd., Madras	5,00,000
...	
Total	<u>50,00,000</u>

On the failure of the company to pay interest and the principal the debenture mortgagees brought a suit in the year 1927 for the enforcement of their mortgage and the recovery of the mortgage-money which had, by that time, accumulated with interest to Rs. 62,00,000. The suit was decreed in February, 1931. During the pendency of the execution proceeding, the Civil Court, with a view to keep the mills running, appointed the assessee in June, 1931, as an Official Receiver of the properties of the company. Eventually it was found necessary to put the mills to sale and the Court appointed the assessee to sell them by auction. This auction was held on 20th January, 1932. There were several bids but the property was hammered out to the decree-holders, who were the highest bidders, through Mr. George A. John, for Rs. 20,80,000. This bid was accepted by the Court and the sale was confirmed on 8th March 1935. There were no cash proceeds of the sale and the sum of Rs. 20,80,000, was set off against the decretal amount.

Under rule 2, Chapter XVII, of the General Rules (Civil) of 1941, poundage is payable to Government at $6\frac{1}{2}$ per cent. of the auction proceeds. It amounted to Rs. 1,30,000 in this case. Under rule 15 of the same rules the Court can allow commission to the auctioneer to the extent of 5 per cent. if the auction is effected by a private person instead of the Amin of the Court. The poundage is payable by auction purchasers who, in the present case, happened to be the decree-holders themselves and at the time of the auction the assessee claimed the lion's share in the decree. Consequently on the representation of the assessee that he should be allowed commission at 5 per cent. for auctioning the property and that he should thus be permitted to deposit the poundage at $1\frac{1}{2}$ per cent instead of $6\frac{1}{2}$ per cent, the Court ordered accordingly. At 5 per cent. the commission amounted to Rs. 1,04,000. As required by rule 15 of the General Rules quoted above, the assessee thus paid on 9th March, 1932, Rs. 26,000 for poundage and Rs. 20,800 for the sale certificate. Both the

amounts were paid in stamps. The total amount of Rs. 46,800 was drawn by the assessee from the Agra branch of the Imperial Bank of India by a cheque on an account which stood in the joint names of the assessee and his brother Mr. George A. John.

When the Income Tax Officer came to know of this transaction, he required the assessee, by means of a notice under Section 22 (2) of the Act to submit a return of his income for the assessment year 1932-33. In response to this notice, the assessee submitted a *nil* return stating that he had no income in the year ending March 1931-32, which was the relevant year of account for the purposes of his assessment. The return was not accepted and the assessee was required to produce accounts and evidence under Sections 22 (4) and 23 (2). The assessee's representative accordingly appeared before the Income Tax Officer and denied his liability to be assessed. It was contended (1) that the assessee did not actually receive any amount by way of commission because being himself interested in the sale the reduced rate at which he was allowed to pay the poundage amounted merely to a reduction in his expenses and not to the receipt of any income, and (2) that, even if the transaction was held to amount to a receipt of the commission, the income was exempt under Section 4 (3) (vii) of the Income Tax Act, being income of a casual and non-recurring nature not arising from business, profession or vocation. The Income Tax Officer overruled these contentions and levied an assessment in the amount of Rs. 1,15,108 including Rs. 11,105 on account of the assessee's share of profits of an association of individuals known as Messrs. John Bros. which is assessed to income-tax separately. A copy of the assessment order will be found in Appendix B.

3. The assessee filed an appeal but was unsuccessful, the Assistant Commissioner holding (1) that in the circumstances stated, the sum of Rs. 1,04,000 representing commission at 5 per cent allowed to the assessee was income in his hands, (2) that the commission must be deemed to have been paid to the assessee on the date on which he deposited the sum of Rs. 26,000 and (3) that the income was not covered by the exemption conferred by Section 4 (3) (vii) of the Act. A copy of the Assistant Commissioner's order is in Appendix C.

It was contended before the Assistant Commissioner that the assessee had acquired the debentures originally held by Sir Edwin John, Mr. H. C. John and the National Bank of India Ltd., but no evidence on the point was produced before him. Having re-

gard, however, to the order of the Subordinate Judge, dated the 26th January, 1932, quoted by the Assistant Commissioner in his order and after further inquiry, I am prepared to concede that, at the time the auction took place, the only persons interested in the sale were the assessee and his brother Mr. G. A. John.

Further, it is not disputed that after the sale of the mills to the Agra United Mills, Ltd., in the year 1920, the only business that the assessee had was that of the sale of motor-cars and accessories. The business was closed by him in June, 1931. The assessee has not been doing any business of his own since then, his half-share in interest on securities and the properties of Messrs. John Bros. being assessed as the income of the association of individuals mentioned above.

4. Questions for the decision of the Honbl'e Court.—(1) In the circumstances of the case (a) is the item of Rs. 1,04,000 liable to tax as income accruing and arising in British India within the meaning of Section 4 (1) of the Act, or (b) constitutes receipts falling under Section 4 (3) (vii) of the Act and hence exempt?

(2) If the answer to part (a) of question (1) is in the affirmative and to part (b) in the negative, was the Assistant Commissioner justified in holding that the item must be deemed to have been paid to the assessee on the day he deposited the sum of Rs. 26,000 representing the difference between the poundage and the commission?

5. Opinion of the Commissioner.—Part (a) of question No. 1.—The assessee's argument as I understand it, is that as there were no sale-proceeds the decree-holders themselves having purchased the property and as the commission could not, therefore, be deducted out of them and paid to him in cash, the effect of allowing him the concession to pay the poundage at $1\frac{1}{2}$ per cent was that the expenses of the execution such as the poundage and the fee for the sale certificate were reduced and it was left to him to recoup himself of the commission earned from the decree-holders who were also the auction-purchasers. As the assessee himself was the main and the major decree-holder, it is argued that he would have to recover it mainly from himself in which event what he would receive would be something which was not a receipt from outside, something that did not come in to him and did not, therefore satisfy the definition of the word "income" as given in the case of *Raja Raghunandan Prasad and another v. Commissioner of Income-tax, Bihar and Orissa* and in the decision of their Lordships of the Privy Council in the case of *Shaw Wallace*

& Co. v. Commissioner of Income-tax, Bengal. To the extent he would have to recover the amount from his brother Mr. G. A. John since there was no settlement of accounts between them it is alleged that the amount would represent only a debt which had accrued and which, in view of the observations of their Lordships of the Privy Council in *St. Lucia Usines & Estates v. Colonial Treasurer* (1924 A.C. 508) would not be income.

Under rule 15 of the General Rules (Civil) of 1911, the commission was the next charge after the poundage on the sale proceeds. Where, owing to the decree-holders being themselves the purchasers of the property and one of them being entitled to the commission, there were no sale-proceeds it would still be open to the auctioneer to insist on the poundage being paid in cash in which event the Court would have allowed him payment in cash. By insisting on the balance of the poundage only being allowed to be paid, the assessee took it upon himself to recover the commission from the other decree-holders and I fail to see how the saving in the expenses thus effected altered the character of the transaction when they could not be properly debited under the Act to the income. On the other hand, it involved a distinct gain to the assessee which is clearly within the purview of Section 4 (1) of the Act. As regards the argument based on the meaning of the word 'income' it seems to me characterized by the fallacy that the commission is likened to a form of return from the poundage and the manner in which it is received is confused with the nature of the amount, whereas the question of recovery is wholly irrelevant to the point immediately under consideration and the position logically resembles that in which an asset is cancelled by a liability. Where, as in this case, this is the position, the authorities relied on by the assessee do not, it is respectfully submitted apply. As between him and the Court the resulting position was that the major portion of the commission was paid through the cancellation of his share of the liability to pay the poundage and the rest through the implicit transfer to him of his brother Mr. G. A. John's share. It was one of his own creation. He cannot turn round and say that his brother has not actually paid him his share of the expenses and may not pay it or he may not choose to recover it from him and that for that reason what has happened is a mere accrual of a debt which, in view of the Privy Council decision in the Colonial case, is not income. There is no question of the accrual of a debt here. The question is one of the transfer of a debt and the decision in the Colonial case is

beside the point. *The poundage was a capital expenditure while the commission was an income receipt.* The one could not be set off against the other for the purposes of an assessment under the Act. I am, therefore, of the opinion that this part of the question should be answered in the affirmative.

As regards the second part of question No. 1, relying again on the observations of their Lordships of the Privy Council in the case of *Shaw Wallace & Co. Ltd.*, referred to above, the assessee argues that even if the amount in question were to be held as income, it was in the nature of a windfall as it could not be said to arise from business and the assessee was not an auctioneer by profession. It may not be income arising from business, but, in my opinion, the commission was the fruit of the continuous exercise of an activity, something that the assessee had worked for, a return that was by no means unexpected and as such not in the nature of a windfall. Indeed, when applying to the Civil Court for the 5 per cent. commission the assessee himself wrote saying "I have been devoting my whole time to my duties as such and have been drawing no remuneration.....etc." (vide Appendix C). Such a remuneration for services rendered can never be casual. It is immaterial that it was for the first time that the assessee had worked as an auctioneer. The correct criterion is, as observed by your Lordships in the case of *Chunnilal Kalyandas* (1 I.T.C. 421) whether the singularity of the transaction is accidental or inevitable. There is nothing in the circumstances of this case to show that it is inevitable. To the like effect are the observations of their Lordships of the Bombay High Court in the case of *Sir Purushottamdas Thakurdas v. Commissioner of Income-tax, Bombay* (2 I.T.C. 18) though the facts of that case were somewhat different from those of this case. The regular profession of an assessee does not appear to me to be material where the receipt arises from work done by the recipient with the idea of getting paid for it. The word 'occupation' occurring in Section 4 (3) (vii) is not defined in the Act and is wide enough to cover a case where the assessee was occupied in the work of holding an auction. Thus the income was, in my opinion, one that did arise from the pursuit of an occupation. I therefore, submit respectfully that the second part of question No. 1 should be answered in the negative.

As regards question No. 2 the commission was payable to the assessee by the Civil Court which had appointed him as an auctioneer. It follows, therefore, that it was paid to him on the date, admittedly within the year of account, on which, with the

permission of the Court, which was granted at his own request, the assessee deposited the balance of the poundage. Agreeing with the Assistant Commissioner, I am therefore, of the opinion that question No. 2 should be answered in the affirmative.

6. As required by rule 7 of the rules framed by the High Court a copy of the relevant portion of the statement of the case was sent to the assessee for his observations and suggestions, if any, within 14 days of the receipt of the memo. The cover in question was delivered to the assessee on 12th July, 1934, and the prescribed time expired on 26th July, 1934, but so far no reply from him having been received the case is finally submitted under Section 66 (2)."

JUDGMENT.

This is a Reference by the Commissioner of Income Tax under Section 66 (2) of the Income-tax Act of 1922.

Two questions are submitted to the Court for decision.

These questions are :—

(1) In the circumstances of the case, (a) is the item of Rs. 1,04,000 liable to tax as income accruing and arising in British India within the meaning of Section 4 (1) of the Act, or (b), constitutes receipts falling under Section 4 (3) (vii) of the Act and hence exempt?

(2) If the answer to part (a) of question (1) is in the affirmative and to part (b) in the negative, was the Assistant Commissioner justified in holding that the item must be deemed to have been paid to the assessee on the day he deposited the sum of Rs. 26,000 representing the difference between the poundage and the commission?

The matter came before a Bench on January 15, 1937. In view of a decision of another Bench of this Court, *In re Gaya Prasad and Chotey Lal*, the case has been referred to a larger Bench for consideration and decision.

The facts of the case which are set out in detail in the Reference may be briefly recapitulated. In 1920 a limited company—the Agra United Mills, Ltd.—purchased from Messrs. A. John & Co. three spinning mills and one flour mill, the purchase price being rupees one crore and twenty lacs. The Company issued Rs. 50 lacs of debentures. The company fell into arrears in respect of payment of interest on the debentures and in 1927 the debenture holders sued the company for a sum of Rs. 62,00,000. The suit was decreed in February 1931. Four months were given to the company for payment of the decretal amount;

in default of payment the debenture holders were given the right to sell the property. The company did not pay, and on January 20, 1932, the mills were sold. At the time of the sale most debentures were held by Major A. U. John, the assessee. He held rupees forty lacs of debentures, the other ten lacs were held by his brother Mr. George A John.

As is stated in the Reference, there were no cash proceeds of the sale since the mills were knocked down to the debenture holders for the sum of Rs. 20,80,000. This sum of Rs. 20,80,000 was set off against the decretal amount.

Under Rule 2 Chapter 17 of the General Rules (Civil) of 1911 poundage was payable to the Government at $6\frac{1}{2}$ per cent. of the auction proceeds. Six and a quarter per cent. amounted to Rs. 1,30,000. Under Rule 15 the Court may allow commission to the auctioneer up to 5 per cent. of the auction price if the auction is conducted by a private person instead of the Amin of the Court.

Now, in the present case, Major A. U. John was appointed auctioneer, and after the sale he moved the Court to be allowed to deposit poundage at the rate of $1\frac{1}{2}$ per cent. instead of $6\frac{1}{2}$ per cent. He prayed that the remaining 5 per cent be treated as auctioneer's commission. To this the Court agreed. Five per cent amounted to Rs. 1,04,000. Accordingly, under rule 15 of the General Rules, the assessee Major A. U. John, paid into Court on March 9, 1932, Rs. 26,000 for poundage and Rs. 20,800 for the sale certificate.

The Income-tax Officer claimed to assess Major A. U. John to income-tax for the year 1931-32 in respect of the 5 per cent. auctioneer's commission above referred to.

Whether or no the assessee is liable to assessment in respect of this sum depends upon whether the sum can be regarded as income within the meaning of the Indian Income-tax Act.

Now, income is nowhere defined in the Act. The question as to what amounts to income under the Income-tax Act however was considered by the Judicial Committee of the Privy Council in the case of the *Commissioner of Income-tax, Bengal v. Shaw Wallace & Co.* In the course of the judgment of the Board, which was delivered by SIR GEORGE LOWNDES, it is observed:—

“The object of the Indian Act is to tax ‘income’ a term which it does not define. It is expanded, no doubt, into ‘income, profits and gains’, but the expansion is more a matter of words than of substance. Income, their Lordships think in this Act connotes a periodical monetary return ‘coming in’

with some sort of regularity or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall. Thus income has been likened pictorially to the fruit of a tree, or the crop of a field. It is essentially the produce of something which is often loosely spoken of as 'capital'. But capital though possibly the source in the case of income from securities is in most cases hardly more than an element in the process of production".

It is apparent to us that in making the above observation the Board had in view the various relevant sections of the Act, and that the Board's intention was to lay down for the guidance of the Courts in India some general principle on the question as to what can be treated as income under the Act. The terms of that part of their Lordships' judgment above quoted are undoubtedly general and, in our opinion, were not intended by their Lordships to be confined to the particular facts and circumstances of the case which their Lordships were considering. It appears to us that their Lordships intended to indicate that the element of periodical receipt or regularity or expected regularity of monetary return was an essential ingredient of 'income' under the Indian Income Tax Act. Their Lordships later in their judgment observe:—

"The claim of the taxing authorities is that the sum in question is chargeable under head (iv), Business. By Section 2 (4) business 'includes any trade, commerce or manufacture, or any adventure or concern in the nature of trade, commerce or manufacture. The words used are no doubt wide, but underlying each of them is the fundamental idea of the continuous exercise of an activity. Under Section 10 the tax is to be payable by an assessee under the head business 'in respect of the profits or gains of any business *carried on by him*'. Again, their Lordships think, the same central idea: the words italicised are an essential constituent of that which is to produce the taxable income; it is to be the profit earned by a process of production. And this is borne out by the provision for allowances which follows."....."Their Lordships will only add that the reasoning of this judgment would apply equally if the appellant based his claim on head (vi) 'other sources' and the corresponding provisions of Section 12".

In *Gaya Prasad and Chhotey Lal, In re*, a Bench of this Court, however, took the view that the observations of the Privy Council above quoted should be taken in conjunction

with the facts of the particular case and that the Board did not intend to lay down any general principle.

We are unable to agree with this view of their Lordships' observations. In our opinion, the intention of the Board was to enunciate a working definition of income for the guidance of the Courts in India. We are confirmed in this view by the fact that in a subsequent case *Maharaj Kumar Gopal Saran Narain Singh v. Commissioner of Income Tax, Bihar and Orissa* in which the circumstances were entirely different the Board approved of the principle laid down in the case of *Commissioner of Income Tax, Bengal v. Shaw Wallace & Co.*

By Section 4 (3) (vii) the Act shall not apply to "any receipts not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee". In our opinion, it cannot be maintained that the auctioneer's commission in the present instance was a receipt arising from business or the exercise of a profession, vocation or occupation, or that it was not of a casual or non-recurring nature, or was by way of addition to the remuneration of an employee. Major A. U. John, who sold debentures belonging to himself and his brother is not an auctioneer and the commission which was earned, if it can be said in the circumstances that he earned commission, did not arise out of the business in which he was engaged nor was it in any way connected therewith.

Sales in execution of a decree of the Court are generally carried out by the Court Amin. Occasionally the duty is assigned to a private person. If that private person is an auctioneer then clearly commission on the sale would be regarded as income. We would observe that not only was the commission unconnected with any business but in fact Major John received nothing at all. The mills were sold at a price a long way below the sum owed to the debenture holders. The court considered it equitable to relieve the debenture holders of the payment of auctioneer's commission, the auctioneer being one of the debenture holders. In the circumstances it would be unreasonable to regard the relief as 'income'. In our opinion nothing in fact was received by Major A. U. John as auctioneer's commission and that in any event even if the relief granted to the debenture holders be regarded as a 'receipt' that receipt did not arise out of any business or the exercise of a profession, vocation or occupation and was of a casual or non-recurring nature.

In the result we hold that the Income-tax Officer was not entitled to assess Major A. U. John for income-tax in respect of the sum above referred to.

We would answer the questions referred as follows :—

1. (a) The item of Rs. 1,04,000 is not liable to income-tax as income accruing and arising in British India within the meaning of Section 4 (1) of the Act.

(b) Even if the same assessee be regarded as having received the sum of Rs. 1,04,000, this receipt is exempt under Section 4 (3) (vii) of the Act.

In view of our answer to question 1, question 2 does not arise.

We fix Rs. 400 as the fee of Counsel for the Income-tax Department. He should file his certificate within six weeks.

Reference answered accordingly.

[IN THE BOMBAY HIGH COURT].

COMMISSIONER OF INCOME-TAX, BOMBAY

v.

BOMBAY TRUST CORPORATION.

SIR J. W. F. BEAUMONT, C.J., and KANIA, J.

March 23, 1938.

ACCOUNT BOOKS—NOTICE TO PRODUCE BOOKS NOT IN POSSESSION OR CONTROL OF ASSESSEE—FAILURE TO PRODUCE—SUMMARY ASSESSMENT—ILLEGALITY OF ASSESSMENT—SCOPE OF SEC. 22 (4)—NON-RESIDENTS—NOTICE ON AGENTS FOR PRODUCTION OF ACCOUNTS—LEGALITY—REFUND—COMMISSIONER'S DUTY TO REFUND TAX ILLEGALLY LEVIED—NECESSITY OF AMENDING ACT—INDIAN INCOME-TAX ACT (XI OF 1922), SECS. 22 (4), 23, 42, 66.

Section 22 (4) of the Indian Income-tax Act (which provides that the Income-tax Officer may serve on any person upon whom a notice has been served under Section 22 (2), a notice requiring him to produce or cause to be produced such accounts or documents as the Income-tax Officer may require) only relates to accounts or documents which are in the possession, or under the control of, the person making the return.

A Company which had its head office at Bombay was required under Section 22 (4) to produce the account books of a company of Hongkong with which it was alleged to be closely connected and an assessment under Sec. 23 (4) was made on the Bombay Company on its failure to produce the books. Held, on a reference, that there was

no evidence to show that the Bombay Company was in law in a position to produce or cause to be produced the books of the Hongkong Company and that the order under Section 22 (4) was not therefore justified and the consequential assessment under Section 23 (4) was also not justified.

Per BEAUMONT, C.J.—“It seems to me desirable.....that the Legislature should consider the desirability of protecting the tax payer from abuse of authority. As the law stands there appears to be no means of compelling the Income-tax Commissioner to refund tax illegally levied.”

Cases referred to :

COMMISSIONER OF INCOME-TAX *v.* BOMBAY TRUST CORPORATION [1930] (54 Bom. 216; 57 I.A. 21; 4 I.T.C. 312; 121 I.C. 532). P.C.

COMMISSIONER OF INCOME-TAX *v.* BOMBAY TRUST CORPORATION [1936] (1936 I.T.R. 323; 164 I.C. 18; A.I.R. 1936 P.C. 269; 63 I.A. 408; 60 Bom. 900; 41 C.W.N. 33).

Case stated by the Commissioner of Income-tax, Bombay, under Section 66 (2) of the Indian Income-tax Act in the matter of the assessment of the Bombay Trust Corporation as agents of the Hongkong Trust Corporation for the year 1928-29. [Civil Reference No. 17 of 1937].

STATEMENT OF CASE.

“Under Section 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as “the Act”), and at the instance of the Bombay Trust Corporation (hereinafter referred to as the “Bombay Company”) as the statutory agent of the Hongkong Trust Corporation (hereinafter referred to as the “Hongkong Company”), I have the honour to refer to your Lordships the question of law set out in paragraph 19 below, which has arisen out of the income-tax and super-tax assessments of the aforesaid Bombay Company as the agent for the Hongkong Company for the financial year 1928-29, ended on 31st March 1929.

Facts of the Case.—The previous history of this case will be found in the statement of the case in Civil Reference No. 10 of 1927 and Civil Reference No. 8 of 1933 and the judgments of the Honourable Court delivered thereon and the judgments of their Lordships of the Privy Council delivered on appeal therefrom (I.L.R. 92 Bombay 702, and 54 Bombay 216, respectively), and these may be referred to, if need be, in connection with the present Reference. To relate in brief this previous history for facility of reference, I beg to state that the share capitals both of the

Bombay Company and of the Hongkong Company and indeed also of Messrs. E. D. Sassoon & Co., Ltd., (hereinafter referred to as the "Sassoon Company") are held almost exclusively by the Sassoon family. The Bombay Company and Sassoon Company were incorporated in Bombay in 1920 and the Hongkong Company at Hongkong in 1921. Up to 1920, the Sassoon family was doing business in Bombay, China, England and other parts of the world as a firm under the name and style of Messrs. E. D. Sassoon & Co. In 1920, this firm was converted into the above two limited companies, *viz.*, the Bombay Company and the Sassoon Company. Both have at all material times had their offices in Bombay at the same place. The Bombay Company had a capital of one crore and all the shares in the limited companies and securities belonging to the old firm, worth several crores of rupees, as also part of the banking and financial business thereof, were transferred to the new company. The Sassoon Company which was also started with a capital of one crore was given the rest of the business of the old firm, *viz.*, business as "General Merchants, Bankers, Commission Agents and Agents of Joint Stock companies". The Hongkong Company is also a financing corporation and was started in 1921 with a capital of 8 crores. It had with it deposits of about the same amount in the years 1924 and 1925. In the words of the Honourable Mr. Justice KEMP (52 Bombay 702, at page 721) "the paid-up capital of the Hongkong Trust Corporation amounted to 8 crores of rupees and it had at its disposal about 7 or 8 crores more of cash deposits received from all sources. It was formed as a limited company and by its Memorandum of Association it was empowered to carry on the business of bankers and financiers, advancing, depositing or lending money and doing this business at Hongkong or any part of the world. In fact its activities were confined to Bombay and to lending money to the Bombay Trust Corporation (*italics*).....There was undoubtedly an intimate connection between the Bombay Trust Corporation and the Hongkong Trust Corporation. The Hongkong Trust Corporation.....lent the whole of the 15 or 16 crores constituting its paid-up capital and cash deposits to the Bombay Trust Corporation from time to time at $5\frac{1}{2}$ per cent interest. The interest accruing due was remitted by the Bombay Trust Corporation through its Bankers, Messrs. E. D. Sassoon & Co., Bombay to Shanghai branch of the same bankers which kept an account of the Hongkong Trust Corporation....." and again (*ibid* at page 723); "There can be little doubt that although the

Hongkong Trust Corporation and the Bombay Trust Corporation were separate legal entities, there was that intimate connection between them as shown by their dealings which shows that the Hongkong Trust Corporation was formed practically for the purpose of lending all its available cash to the Bombay Trust Corporation and the intermediary between the two Corporations were the bankers E. D. Sassoon & Co. The Hongkong Corporation lent all its paid-up capital and cash deposits apparently without security to the Bombay Company."

3. The connection between these three companies has been further described in paragraphs 25 and 26 of the judgment of SIR AMBERSON MARTEN, Chief Justice, in the above Reference (52 Bombay at page 718) as under :—

"We are dealing in enormous figures and substantially the Bombay Company was being financed to the extent of 15 or 16 times its paid-up capital by a fairy god-mother in the shape of the Hongkong Company who was prepared to lend them almost unlimited sums at $5\frac{1}{2}$ per cent interest without security, and in its turn the Hongkong Company was risking double the amount of its paid-up capital and all its available deposits.

"Under those circumstances it seems to me that there was a strong business connection between the two companies. The business interests of the Hongkong company were practically entirely wound up in the business welfare of the Bombay Company. The failure of the latter would have involved the ruin of the former. Consequently, I need say nothing as to the fact that behind these strong financial ties was the family house of Messrs. E. D. Sassoon & Co., Ltd., as the banker intermediary. Nor need I in any way lay stress on such family connections as there might be between the various share-holders or directors of the three companies."

4. Though the Hongkong Company was created in 1921, it was not till the year 1926 that this Department became aware of its existence and of its intimate business relation with the Bombay Company. It then became known that it had loaned to the Bombay Company in 1924-25 about 16 crores of rupees, that is, in fact, all its available resources, without any security, and that the amount was lent by way of fixed deposits at $5\frac{1}{2}$ per cent. interest and also that the money was transmitted through the Sassoon Company and that the interest was paid through its head office at Bombay and its branch at Shanghai. The Income-tax Department, therefore, started proceedings to levy tax on the interest

exceeding Rs. 80 lakhs per annum which the Bombay Company was paying to the Hongkong Company, treating the former as the statutory agent of the latter under Section 43 of the Act.

5. Before a resident can be treated as the statutory agent of a non-resident under Section 43 of the Act for the purposes of taxation, the proviso to that section requires that the resident should be given an opportunity to show cause why he should not be held liable to tax as agent of the non-resident. Accordingly, on 14th October 1926, the Senior Income-tax Officer, Bombay, issued a notice to the Bombay Company calling upon it to state why it should not be treated as the agent of the non-resident Hongkong Company in respect of the interest income earned by the latter on the loan given by way of fixed deposits for a year and renewed from year to year. Shortly after these proceedings were started, however, the above fixed deposits which then amounted to the enormous figure of 11 crores of rupees, were shown in the accounts of the Bombay Company as converted on 13th November 1926 into call loans payable as soon as demanded, and thereafter within the short space of four days, namely, on the 17th November 1926, as actually paid off with interest. It was in fact, curiously enough on that very date that the Senior Income-tax Officer, after holding the Bombay Company liable as the statutory agent of the Hongkong Company under Section 43 of the Act, called upon it as such agent to put in returns of the income under Section 22 for the years 1925-26 and 1926-27. The above large sum of 11 crores of rupees was not held by the Bombay Company in cash so as to be available for repayment at a moment's notice (or four day's notice), but was locked up in shares and securities and in the business. By converting a fixed deposit into a call loan, a liability to pay back immediately on demand was created, the Sassoon Company being throughout the banker intermediary between the Hongkong Company and the Bombay Company transferring the loans from the account of the Hongkong Company to the Shanghai branch of the Sassoon Company, so that it appeared that the Hongkong Company was paid off through the Sassoon Company and that moneys had been borrowed from the Sassoon Company. Nothing was in fact paid to the Sassoon Company or received from it in cash. These were all book entries. The Sassoon Company, Shanghai, did not in its return, pay off the amount in cash to the Hongkong Company but merely credited the amount in the current account of the Hongkong Company in its account books. Thus, while the entries in the books before 17th November 1926 showed

that the Bombay Company was a debtor to the Hongkong Company direct, as and from 17th November 1926, the Bombay Company appeared in the books as debtor of the Sassoon Company, Shanghai, and the latter as debtor to the Hongkong Company.

6. As regards the payments of interest on these loans prior to 17th November 1926, it was shown in the accounts remitted to the Hongkong Company through the Sassoon Company, Shanghai. After 17th November 1926, it is shown as paid to the Sassoon Company, Shanghai.

7. Now reverting for a moment to the history of the previous litigation herein, the Senior Income-tax Officer, Bombay as stated above decided on 16th November 1926, to treat the Bombay Company as the statutory agent of the Hongkong Company and on 17th November 1926 called upon it as such to put in returns of income under Section 22 of the Act for the two years 1925-26 and 1926-27. He then levied assessments for these years and the Bombay Company denying its liability to be assessed, appealed to the Assistant Commissioner, the matter thereafter being referred to the High Court which decided that there was a business connection between the two companies within the meaning of Sections 42 (1) and 43 and that the interest income had accrued to the Hongkong Company from such business connection, but the Bombay Company could not be assessed as its agent inasmuch as it could not be said to have been in receipt of the income in question within the meaning of Section 40. On appeal to the Privy Council, their Lordships held that under Section 43 of the Act, the Bombay Company was to be deemed the agent of the Hongkong Company for all the purposes of the Act and as such under Section 42 (1), the assessee was liable for the payment of income-tax. In pursuance of this decision, tax was levied upon and duly recovered from the Bombay Company as the statutory agent of the Hongkong Company for the financial years 1925-26, 1926-27 and 1927-28, on the basis of the income accruing and arising in the calendar years 1924, 1925 and 1926 respectively, which were the "previous years" for the purposes of these assessments as defined in Section 2 (11) of the Act. The appeal against assessments for the years 1925-26 and 1926-27 was heard in February and March 1927, i.e., after the alleged severance of all connection between the Bombay Company and the Hongkong Company on 17th November 1926. The following figures, however, extracted from the account books of the Hongkong Trust Corporation, were actually supplied

in March 1927 to the appellate authority in a statement filed as Exhibit G in the appellate record for those years.

Ex. G.

J. B. V.

31st March 1927.

"Hongkong Trust Corporation.

Total deposits received from all sources.

	Rs.	A.	P.
Forward as at 30th June 1924	8,42,94,209	8	4
Received during 1924-25	83,54,506	13	5
	<hr/>		
	9,26,48,716	5	9
Less total deposits repaid	1,80,56,863	2	8
	<hr/>		
As at 30th June 1925	7,45,91,853	3	1
Received during 1925-26	4,13,23,229	10	7
	<hr/>		
	11,59,15,082	13	8
Less total deposits repaid	5,49,47,076	2	2
	<hr/>		
	6,09,68,006	11	6
	<hr/>		
Deposits made with Bombay Trust Corporation.			
Forward 30th June 1924	15,85,16,109	0	1
Made during 1924-25	16,32,00,761	13	0
	<hr/>		
	32,17,16,870	13	1
Repaid by B.C.T. during 1924-25	16,85,91,123	1	3
	<hr/>		
As at 30th June 1925	15,31,25,747	11	10
Made during 1925-26	11,04,85,918	0	1
	<hr/>		
Repaid by B.C.T. during 1925-26	26,36,11,665	11	11
As at 30th June 1926	15,31,25,140	11	10
	<hr/>		
	11,04,86,525	0	1
	<hr/>		
Total interest received or accrued—			
1925	from B.C.T.	All sources.	
June 30	83,87,013 2 0	91,31,505	15 9
1926			
June 30	54,77,088 5 9	85,89,879	10 0

Total interest paid or accrued—

1925

June 30 47,92,696 15 1

1926

June 30 48,85,299 8 3"

8. Thereafter came the assessment in dispute, which is for the year 1928-29 ended on 31st March 1929 and is based on the income for the calendar year 1927. When the Income-tax Officer called for a return of income for that year, the Bombay Company replied that the loans from the Hongkong Company were all paid off on 17th November 1926. In proof of this assertion, the only evidence put forward consisted of the entries in the books of the Bombay Company. The Income-tax Officer, however, was not satisfied with this evidence and regarded as illusory the book entries which purported to record the repayment of the loans. He accordingly held that the Hongkong Company had continued to lend money to the Bombay Company even after 17th November 1926 and he assessed the Bombay Company as agent of the Hongkong Company on an income of Rs. 33,42,270 on account of the interest shown by the Bombay Company in its account as having been paid, as in the past, to the Shanghai branch of the Sassoon Company, Shanghai.

9. Against the above order, the Bombay Company appealed to the Assistant Commissioner of Income-tax, B Division, Bombay. The Assistant Commissioner too agreed with the Income-tax Officer and confirmed the assessment by his order dated 12th July 1930, a copy of which is annexed hereto as Exhibit A. On 6th September 1930, the Bombay Company applied to the Commissioner for a reference to this Honourable Court. The Commissioner thereupon called for the papers of the case under the authority vested in him under Section 33 of the Act, and, after going through them and hearing the Attorneys for the Bombay Company, directed the Assistant Commissioner to take back the appeal on his file, make further inquiries and then decide it in view of such further evidence as might be put in. The Assistant Commissioner accordingly took back the appeal and after further inquiries decided it on 9th October 1931. A copy of the decision is annexed as Exhibit G in the records of the Civil Reference No. 8 of 1933 and is, for ready reference, hereto annexed, marked Exhibit A A. While contending that no business connection existed between the two companies since 17th November 1926, the Bombay Company, for the purpose of reducing the quantum of the

assessment, supplied to the Assistant Commissioner and the Commissioner copies of the Profit and Loss Accounts and Balance Sheets of the Hongkong Company for the years ended 30th June 1927 and 30th June 1928, and statements containing figures of total interest income earned etc., copies of which are all annexed hereto collectively marked Exhibit B. A consideration of these figures led the Assistant Commissioner to reduce the income liable from as much as Rs. 33,42,270 to Rs. 20,50,000.

10. On receipt of the Assistant Commissioner's decision, the Bombay Company applied to the Commissioner for a Reference to the High Court. Thereupon the Commissioner passed an order (copy annexed hereto marked Exhibit C) dated 18th February 1932 declining to make a reference on the ground that no question of law arose in the case. The Bombay Company then applied to your Lordships under Section 66 (2) of the Act and your Lordships required the following question to be stated for decision by the Honourable Court:—

“Whether there was any evidence to justify the finding of the Assistant Commissioner that for the year of assessment, profits and gains accrued or arose to the Hongkong Trust Corporation through its business connection with the Bombay Trust Corporation”.

The case was accordingly stated to your Lordships, being Civil Reference No. 8 of 1933. After hearing the case, your Lordships delivered on 29th August 1933 the judgment of the Honourable Court answering the above question in the negative.

11. A copy of the judgment of the Honourable Court was certified to me on 1st November 1933. Shortly after the Honourable Court decided the case, confidential information from a reliable source was received to the effect that the entries in the books of the Hongkong Company itself did not support the story of the alleged repaying of the loan. I had, it will be noted, in the last but one sentence in paragraph 4 of my order dated 18th February 1932 (Exhibit C), stated that “The most important evidence, viz., the account books of E. D. Sassoon & Co., Shanghai, and of the Hongkong Trust Corporation were never produced. Hence on receipt of a copy of your Lordships' decision, the question arose as to whether further evidence consisting of the books of the Hongkong Trust Corporation could or could not at that stage be called for. After the most careful consideration, the conclusion arrived at was that in the circumstances of the case, further evidence of a decisive nature such as the account books of the very person whose

income was under assessment could or should be called for at that stage. I was in fact always of opinion that the account books of the Hongkong Corporation would be the most important piece of evidence, but, as I considered that under Section 23 (2) positive evidence in support of the Income-tax Officer's assessment was in the circumstances not necessary, these books were not actually called for prior to your Lordships' judgment. From that judgment, however, it was clear that some positive evidence was necessary to support the assessment made by the Income-tax Officer. The assessment was a very important one involving a very large amount of tax. Not only that, but assessments for the three following years levied exactly on the same basis were also under consideration and the whole of the dispute would be settled once and for all on the production of this really vital piece of evidence in the case. In addition, the confidential information to which I have referred made it necessary, in the interests of the Crown to make sure that this was not an attempt to avoid the tax rightly due.

I interpreted your Lordships' judgment as meaning no more than that the assessment records, as they existed then, did not disclose any evidence to support the finding of the Assistant Commissioner and accordingly, on 16th January 1934, an order was passed by me under Section 66 (5) of the Act to the effect that the Assistant Commissioner should take back the appeal on his file under clause (b) of sub-section (3) of Section 31 of the Act, set aside the assessment levied as the Honourable Court had found that there was no evidence to support it and direct the Income-tax Officer to make a fresh assessment after making such further enquiry as the Income-tax Officer might think fit in view of the decision of the High Court.

12. The Assistant Commissioner thereupon took back the appeal on his file, set aside the assessment made and directed the Income-tax Officer to make a fresh assessment after making such further enquiry as he might think fit. In respect of this appellate order passed under Section 31 of the Act it is important to note that the Bombay Company had every right to call for a reference to this Honourable Court under Section 66 (2) of the Act in case it thought the order to be *ultra vires*, but it took no such steps to contest it and the Assistant Commissioner's order thus became final and binding under the Act.

13. On receipt of the Assistant Commissioner's above order, the Income-tax Officer, on 30th January 1934, issued a notice under Section 23 (2) of the Act requiring the Bombay Company

to produce on 15th February 1934, evidence in support of the return of income put in by it. On the same date, *i.e.*, 30th January 1934, the Income-tax Officer also issued a notice under Section 22 (4) of the Act requiring the assessee to produce on 15th February 1934 the books of account of the Hongkong Company for the year ended 31st December 1927. In response to the said notices, Mr. Daji, Solicitor, attended before the Income-tax Officer with Mr. Gilroy, the Company's Accountant, on 15th February 1934 and contended that the loan from the Hongkong Company having been repaid on 17th November 1926, no interest was paid to it in 1927 and that there were no further proofs except the books of the Bombay Trust Corporation which showed the repayment of the loan. As regards the notice under Section 22 (4), he contended that the books of the Hongkong Company were not and could not be in the possession or control of the Bombay Trust Corporation and that the latter was not therefore in a position to produce them. It was not urged by him that the time given was too short to enable him to produce the accounts called for. As the required books were not produced, the Income-tax Officer, for reasons given in detail in his order dated 15th February 1934, considered that the default was deliberate and levied an assessment to the best of his judgment under Section 23 (4) of the Act. A copy of the assessment order passed is annexed to and marked Exhibit D. The Income-tax Officer has stated therein that the assessee was not prepared even to attempt to get the books as they did not ask for further time for that purpose and as they could easily have produced the books in view of the very intimate connection between them and the fact that Sir Victor Sassoon was "the centre of control and influence in the management of the three companies", *viz.*, these two and the Sassoon Company. It was evident that the books were not produced because it was realised that they would "not support the entry in the books of the Bombay Trust Corporation" as regards the repayment of the loans. Under Section 23 (4) of the Act, when an assessee "fails to comply with all the terms of a notice issued under Section 22 (4)", the Income-tax Officer is required to "make the assessment to the best of his judgment". The original assessment was on a total income of Rs. 33,42,270 but as in the course of the appellate proceedings as regards that assessment, the Bombay Company had put in two Balance Sheets of the Hongkong Company for the years ended 30th June 1927 and 30th June 1928 and certain other documents (Exhibit B), and had contended on the strength thereof that the sum of

Rs. 33,42,270 represented the gross amount of interest and that the Hongkong Company had itself to pay interest on moneys borrowed by it for these loans to the Bombay Company, the Income-tax Officer took these documents into consideration and after making an allowance on the strength thereof, assessed the income at Rs. 20,50,000. At the same time, he directed that the amount to be refunded in respect of the first assessment which had been held invalid, should be set-off, under Section 49-A against the present assessment. I might add here that whenever an assessee is unable to produce the required proofs within the time given for that purpose, the practice of the Department is to grant further time looking to the circumstances of the case and the Solicitors of the Bombay Company were well aware of the practice. However, the intention obviously being not to produce the accounts called for, no further time was in fact asked for, as appears from the following passage in the order of the Income-tax Officer :

“When asked as to whether the Company will be able to obtain them and when, Mr. Glover says that he is not in a position to state anything further as to whether he will be able to produce them even if allowed time. He is attending to-day to reply to requisition for certain books and can only say that they are not available.”

14. In respect of the above assessment, the Bombay Company made an application dated 14th March 1934 (copy annexed and marked Exhibit E) to the Income-tax Officer requesting him to set it aside under Section 27 of the Act. Also, although the proviso to Section 30 (1) of the Act absolutely bars an appeal under that section to the Assistant Commissioner in the matter of an assessment under Section 23 (4) of the Act, the Bombay Company on the same date appealed to the Assistant Commissioner requesting him to cancel the assessment as invalid and unwarranted by law, on the ground that this Honourable Court had already decided that there was no evidence to support the original assessment. A copy of the application is annexed hereto and marked Exhibit F.

15. When the Assistant Commissioner passed his order under Section 31 of the Act, setting aside the original assessment and directing the Income-tax Officer to levy fresh assessment, the Bombay Company were entitled, as stated above, to apply to the Commissioner under Section 66 (2) of the Act asking him to refer the case to the Honourable Court to decide the question of law whether in view of the judgment of your Lordships, it was open

to the Assistant Commissioner under Section 31 (3) (b) of the Act to direct the Income-tax Officer to levy a fresh assessment after further inquiry. Had it done so, the case would have been referred to the Honourable Court and pending its decision, no action would have been taken as regards re assessment. It did not, however, take this simple course, but, when fresh assessment was actually levied, appealed erroneously, to the Assistant Commissioner. Meanwhile, as proceedings were started to lodge an appeal against the decision of this Honourable Court on the reference above mentioned, the Commissioner informed the assessee on 5th July 1934 that the proceedings would be postponed pending the decision of their Lordships of the Privy Council. Thereafter on 23rd August 1934, the Bombay Company applied the Honourable Court under Section 45 of the Specific Relief Act, to set aside the fresh assessment as illegal and order a refund in cash of the sum of Rs. 3,17,187-8-0 which, as above stated, had been set off under Section 49-A of the Act against the fresh assessment levied by the Income-tax Officer. The Honourable Court directed a refund to the Bombay Company of the said sum of Rs. 3,17,187-8-0, but on appeal to His Majesty in Council, the order passed by the Honourable Court was set aside, their Lordships of the Privy Council holding as follows (see the judgment delivered on 17th July 1936 in the matter of the consolidated Privy Council appeals Nos. 85 of 1935 and I of 1936, reported in 60 Bombay 900; 1936 I.T.R. 323):—

“Before the assessee had brought their application on 23rd August 1934, there was in existence the order under Section 49-A based upon the fresh assessment of 15th February. To get rid of that order it was necessary that proceedings should be taken under Section 27, and it was not open to the assessee to apply to the Court for an order setting aside the assessment or the set off made thereunder.”

Their Lordships further held that “in substance the Commissioner was within his rights in directing further inquiry,” and that “however disappointing this course may have been to the assessee, it is a matter which a court of law must leave in the discretion of the Commissioner.”

16. On the receipt of the above judgment of their Lordships of the Privy Council, the petitions (Exhibits F and E) which had been presented to the Assistant Commissioner and to the Income-tax Officer respectively were forthwith taken up for consideration on their merits. The assessment being one under Section 23 (4) of the Act, no appeal lay to the Assistant Commissioner and the

Assistant Commissioner accordingly by his order dated 30th November 1936 refused to entertain the said petition. As stated in the judgment of their Lordships of the Privy Council, the only proper and legal course for the Bombay Company was to proceed against the assessment levied under Section 23 (4) by applying to the Income-tax Officer under Section 27 to re-open the case, and the Income-tax Officer therefore proceeded to hear the application made for that purpose (Exhibit E). After hearing the representatives of the Bombay Company, *viz.*, Mr. Gilroy and Mr. Daji, Solicitor, the Income tax Officer by his order dated 8th December 1936 declined to cancel the assessment made and to proceed to make a fresh assessment under Section 27 of the Act. A copy of the said order is annexed hereto and marked Exhibit G. In the said order, the Income tax Officer has dealt fully with all the points raised on behalf of the company. He has pointed out in reference to a contention put forward that the proceedings referred to were started by him as directed in an appellate order of the Assistant Commissioner passed under Section 31 (3) (b) of the Act that in case the assessees thought that the order was invalid, they should have called for a reference to the High Court on questions of law arising out of that order under Section 66 (2) of the Act, and that as they did not choose to do so, the order under Section 31 (3) (b) became final and binding. The default under Section 22 (4) consisted in not producing the accounts of the Hongkong Company and the assessee's Solicitor explained that the Bombay Company had not and could never have possession of, or control over the books of the said Hongkong Company and that therefore it could not produce them. The Income-tax Officer, however, held that having regard to the very close and intimate connection between the two concerns, just as Balance Sheets of the Hongkong Company for the purpose of the original assessment for this very year had been produced by the Bombay Company in May 1930 (along with other details from the account books of the Hongkong Company), the account books could also have been produced, but that they appeared to have been kept back deliberately with a view to suppress evidence that would have disproved the alleged repayment of the loan. The Income tax Officer further observed that the fact that the above mentioned Balance Sheets of the Hongkong Company were produced in May 1930, notwithstanding the allegation that all connection between the two concerns had ceased from 17th November 1926, only went to show that in May 1930 also there was business connection. The

Income-tax Officer has further noted in his order that he told the Solicitor, Mr. Daji, about the confidential information he had received and expressed his willingness to give as much time as might be considered necessary for the production of the said books but that Mr. Daji asserted his inability to produce them.

17. Against the above order of the Income-tax Officer passed under Section 27 of the Act (Exhibit G), the Bombay Company preferred an appeal to the Assistant Commissioner under its petition of appeal dated 12th January 1937, a copy of which is annexed hereto, marked Exhibit H. In the said appeal, it once more contended that the Bombay Company could not produce the Hongkong books as it had no control over them and that in law it could not be asked to produce the said books even on the assumption that it was the statutory agent of the company in question, much less could it do so when it was not such an agent. After hearing the representatives of the Bombay Company, the Assistant Commissioner rejected the appeal for reasons given fully in his appellate order dated 10th March 1937, a copy of which is annexed hereto, marked Exhibit I. He has stated that he agreed with the Income-tax Officer that Section 22 (4) of the Act empowered an Income-tax Officer to call for such accounts or documents as the Income-tax Officer might require, that when the Bombay Company could procure sworn declarations of responsible auditors and officers of the Hongkong Company as well as copies of the most important part of its account books, *viz.*, the balance sheets for the year ended 30th June 1929, it could as easily have produced the account books themselves if it had a mind to do so, as the two concerns were throughout working hand in hand, in close and intimate connection, and that the default was deliberate in order to avoid production of evidence which would go against it.

18. Being dissatisfied with the above order of the Assistant Commissioner, the Bombay Company has by its petition dated 27th April 1937 (a copy annexed hereto marked Exhibit J) requested me to refer the case to your Lordships. I submit accordingly this Statement of the Case for favour of decision of the question of law stated below that arises out of the Assistant Commissioner's above appellate order.

19. Question of law for decision of the Honourable Court :—
I submit the following question of law for favour of decision :—

“Whether there was any material on which the Assistant Commissioner could find that there was not sufficient cause preventing the Bombay Company from producing the account books

of the Hongkong Company as required under the notice issued by the Income-tax Officer under Section 22 (4) of the Act."

20. Opinion of the Commissioner:—As Section 66 (2) of the Act requires that the Commissioner should give his opinion while submitting this Statement of the Case, I beg to say that I am respectfully of opinion that the answer to the question should be in the affirmative. Briefly stated, the facts are that the Income tax Officer required the Bombay Company to produce the accounts of the Hongkong Company under Section 22 (4) of the Act and the former failed to do so. Hence the Income-tax Officer levied an assessment to the best of his judgment under Section 23 (4) of the Act and the Bombay Company applied to him under Section 27 of the Act to reopen the case. The question for decision before the Income-tax Officer then was whether the assessee was prevented by sufficient cause from complying with the notice under Section 22 (4) of the Act. Reference might perhaps, on this point, usefully be made to a recent judgment of their Lordships of the Privy Council delivered on 19th February 1937 (*Commissioner of Income-tax, Central and United Provinces v. Laxminarain Badridas*, 1937 I.T.R. 170), where their Lordships observed as follows:—

"If the assessment in this case was made by the Officer to the best of his judgment, it must stand unless the assessee succeeded in satisfying the officer that he had not a reasonable opportunity to comply or was prevented by sufficient cause from complying with the terms of the notice under Section 22 (4) requiring him to produce or cause to be produced his accounts for three years. This he failed to do, and upon the undisputed and indisputable facts of the case he necessarily so failed. His application under Section 27 for cancellation of the assessment was doomed to failure, and his appeal to the Assistant Commissioner under Section 30, was equally incapable of success. There the matter should have ended, unless the Commissioner chose to proceed under Section 33."

The company said that it could not comply with the Income-tax Officer's requisition as it was neither in possession of, nor control over, the account books of the Hongkong Company. For reasons given fully and clearly in his order under Section 27 (Exhibit G), the Income-tax Officers's finding was that the Company had wholly failed to show sufficient cause. It then appealed to the Assistant Commissioner and he agreed that there was not sufficient cause preventing the company from producing the account books of the Hongkong Company. The only question for

consideration now is whether there was any material on which the Assistant Commissioner could base such a finding. Looking to the Assistant Commissioner's order, he appears to have based it on the following materials:—

(a) Evidence which showed that there was very close and intimate connection between the Bombay Company and the Hongkong Company. This Honourable Court itself inferred therefrom that the latter Company was "the fairy god-mother" of the former company in the judgment in Civil Reference No. 10 of 1927 (vide paragraphs 2 and 4 *supra*). In their judgment dated 17th July 1936 in the matter of the assessment for this very year under dispute referred to in paragraph 15 above, their Lordships of the Privy Council, speaking, at any rate, of the position in 1925 and 1926, have stated that "Their Lordships are well satisfied that all these companies were closely associated, that in the words of Sections 42 and 43 there was a business connection between them and that they were working in this matter in concert as though under one control."

(b) Evidence which proved the fact that the Bombay Company did on 20th May 1930 (the date 17th May 1930 has been wrongly quoted by the Assistant Commissioner) and thereafter procure and place before the Assistant Commissioner copies of the most important part of the accounts of the Hongkong Company now called for under the notice issued under Section 22 (4) of the Act, *viz.*, the Profit and Loss Accounts and Balance Sheets for the years ended 30th June 1927 and 1928 (Exhibit B).

(c) Evidence which proved the fact that the Bombay Company did procure before the Assistant Commissioner in the matter of the appeal, against the original assessment "sworn declarations of responsible auditors and officers of the Hongkong Trust Corporation."

After a very careful consideration of the above facts and evidence on which they were based, I am respectfully of opinion that there was not only "material" but ample material on which the Assistant Commissioner could find that sufficient cause was not shown for not producing the account books of the Hongkong Trust Corporation. The only cause alleged was that it was impossible to produce the books called for, as they were not under the control of the Bombay Company. Though Section 22 (4) does empower an Income-tax Officer to call for "such accounts or documents as the Income-tax Officer may require", yet, as "*lex non cogit ad impossibilia*", it must, of course, be deemed to

be sufficient cause for not producing the accounts called for if it was really impossible for the person asked to produce them to do so. However, in the words of the late Mr. Justice KEMP, all the activities of the Hongkong Company "were confined to Bombay and lending money to the Bombay Trust Corporation" and "the Hongkong Trust Corporation was formed practically for the purpose of lending all its available cash to the Bombay Trust Corporation" without any security whatever. Thus in this case we have two companies which are proved to be so closely associated that the one can be styled by this Honourable Court itself as "the fairy god-mother" of the other and that their Lordships of the Privy Council could say that they were "closely associated" and "working in the matter in concert as though under one control." When the two concerns are thus found to be working "in concert as though under one control" there can surely be no doubt whatever that one of them could without the least trouble produce the account books of the other when asked to do so in the matter of a very important assessment to income-tax amounting to over three lacs of rupees. As stated by the Income-tax Officer in his order (Exhibit G), not only the assessment but the assessments for the three subsequent years all depended on the production of these books. Concerns "working in concert as though under one control" would never take up the attitude of leaving one of them to pay lakhs of rupees by way of tax when by simply producing the accounts of the other, all that could be easily avoided. Not only was the connection between the two such that the books could have been very easily produced but as a matter of fact, the most important part of the very accounts that were called for, *viz.*, the Profit and Loss Accounts and the Balance Sheets (Exhibit B) of the Hongkong Company, was actually produced in May 1930 and thereafter by the Bombay Company when it suited it to do so to get the assessment reduced. If the Hongkong Company could trust the Bombay Company with its Balance Sheets and Profit and Loss Accounts, surely it would have trusted it with its books too. I am therefore quite unable to assume that it was impossible for the Bombay Company to produce the books called for. The very reason given by the Bombay Company for not producing the account books even though the Balance Sheets and the Profit and Loss Accounts were produced, being totally incorrect shows that the books have been deliberately withheld. The explanation was that the Balance Sheets could be produced because there was business connection at that time. This cannot be

correct as the allegation of the Bombay Company was that all the business connection with the Hongkong Company ceased on 27th November 1926, whereas the Balance Sheets were put in on 20th May 1930, *i.e.*, nearly 3½ years thereafter. Even the Balance Sheets and the Profit and Loss Accounts and other figures from the accounts of the Hongkong Company which were put in for the purposes of the assessments of the two prior years, *viz.*, 1925-26 and 1926-27 were put in in March 1927, *i.e.*, over three months after the alleged cessation of business connection (*vide* paragraph 7 above). As regards the very intimate connection between the two concerns, the Assistant Commissioner says that instead of giving any explanation as to why, in spite of such very close and intimate connection, the books could not be produced, the Bombay Company merely brushed aside the point as "worn out stories". This is very strange as the very close and intimate connection is not a mere story but a decision of the highest tribunal in the land. As a matter of fact it appears from the Assistant Commissioner's order that having nothing to urge as regards the real issue in the case, an attempt was made to cloud it by saying that this was a matter which was "finally decided and disposed of by all tribunals" and that the assessment levied was already "adjudicated by the High Court and the Privy Council as illegal". When their Lordships of the Privy Council have definitely said in their judgment as regards the assessment under dispute levied on 15th February 1934 that "to get rid of that, it was necessary that proceedings be taken under Section 27 and it was not open to the assessee to apply to the Court direct for an order setting aside the said assessment," it is really impossible to see how such arguments could be advanced.

21. Attention is invited in this connection to the very pertinent remarks made by SIR GEORGE RANKIN, C.J., in the judgment of the Calcutta High Court in the referred case of *Messrs. Har-mukhrai Dulichand v. Commissioner of Income-tax, Bengal* (3 I.T.C. 198 at p. 207). Just as in the present case, the Income-tax Officer in that case issued a notice under Section 23 (2) of the Act asking the assessee to put in proofs on which they relied in support of their return of income and another under Section 22 (4) of the Act asking them to put in their account books. The assessee put in certain evidence in compliance with the notice under Section 23 (2) of the Act and did not comply with the notice under Section 22 (4) of the Act. As regards such a case, His Lordship says in his judgment as under at page 207 :—

"The Income-tax Officer may well say 'you are in default for withholding your accounts. You will be dealt with on that basis. In the absence of available accounts, neither argument nor other evidence is anything but a waste of time. It is *mera palpatio*. You will be treated as defaulters and in no other way'. In my judgment that is what the statute intends. The statute intends that persons who deliberately make default in producing their accounts when asked to do so under clause (4) of Section 22 shall be treated as defaulters and that the Income-tax Officer shall make assessment to the best of his judgment".

Further down on the same page, His Lordship observes as under :—

"However true it be and for whatever purpose it be true that the assessment to income tax is to be done in a judicial manner, the first thing which must be laid down as a condition before a person can complain of any departure from this principle is this, that he too must produce the evidence which the law requires him to produce. It is idle and absurd for a person who has books of account and deliberately withholds them to complain of not being treated in a judicial manner. The judicial manner is a manner which proceeds upon evidence, and the basis of the statute is to see that available evidence is produced. It is then and only then that the assessment is to be made upon a judicial consideration of the evidence. Otherwise it is to be made 'to the best of his judgment' and *brevis manu*".

As observed by this Honourable Court in its previous judgments and by their Lordships of the Privy Council in their recent judgment referred to above, when the Hongkong Company "was formed practically for the purpose of lending all its available cash to the Bombay Company", when the former "was prepared to lend almost unlimited sums at $5\frac{1}{2}$ per cent. interest without security" as if it were its "fairy god-mother", when "business interests of the Hongkong Company were practically entirely wound up in the business welfare of the Bombay Company", when the failure of the latter would have involved "the ruin of the former", and when "they were working in this matter in concert as though under one control", the Bombay Company could have, if it wanted to, produce the account books of the Hongkong Company beyond any doubt. It deliberately failed to do so and the complaint made by it against the best judgment assessment levied in consequence is, in the words of the learned Chief Justice who decided the above Calcutta case, both "idle and absurd". The Income-tax Officer

had in consequence to make an assessment to the best of his judgment and in the words of LORD MACKENZIE in the case of *Macpherson & Co. v. Moore* (6 Tax Cases 115) "If an Act of Parliament says the amount of profits is to be ascertained, ascertained they must be whether they can be done in a satisfactory method or not." If Section 23 (4) of the Act requires the Income-tax Officer to ascertain the total income, ascertain he must, whether that can be done in an entirely satisfactory method or not.

22. For all the aforesaid reasons, I am respectfully of opinion that the question put should be answered in the affirmative as stated above. Before concluding, I might add that even though the Income-tax Officer offered to give to the Bombay Company as much time as it wanted to produce the Hongkong books, it failed to take advantage of the opportunity. In the Specific Relief proceedings, while complaining about the 15 days' time given to produce the accounts, it did not bring to your Lordships' notice the fact that it never told the Income-tax Officer that the period of 15 days given to produce the said accounts was too short and that it never asked for further time. The Income-tax Officer in his assessment order dated 15th February 1934 (Exhibit D) has stated "It is said that the books of account of the Hongkong Trust Corporation Ltd., cannot be produced here on the plea that they are not under the control of the Company in Bombay. The statement is almost a categorical refusal to produce the books, as not so much as willingness to produce them was expressed. The assessee is, it appears to me, not prepared even to try to get them, as they would have asked for time to obtain the books or even to get a reply from the Hongkong Company". In the present proceedings, the Bombay Company has avoided that point and when the Income tax Officer brought the matter to a head by offering to give as much time as it wanted to produce the books, it virtually expressed its unwillingness to produce them. As a matter of fact, the assessee did not in the Specific Relief proceedings which were not based on any Statement of the Case submitted by the Department, fully state the correct facts in other respects too. However, as it is not necessary for the purposes of this reference to point that out in detail, I refrain from doing so here, especially as the decision of your Lordships is to be based on facts as stated in this Statement of the Case.

23. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act".

JUDGMENT.

BEAUMONT C.J.—This is a reference by the Commissioner of Income-tax under Section 66 (2) of the Indian Income-tax Act raising the question whether there was any material on which the Assistant Commissioner could find that there was not sufficient cause preventing the Bombay Company from producing the account books of the Hongkong Company as required under the notice issued by the Income-tax Officer under Section 22 (4) of the Act.

Shortly, the facts which give rise to the question are these:—The Bombay Company which is referred to in the question is a company carrying on business in Bombay. The Hongkong Company is carrying on business in Hongkong. In respect of the year 1926-27 the Bombay Company was assessed to tax as the statutory agent of the Hongkong Company. The matter was in dispute and carried to the Privy Council who held that there was a business connection between the two companies and that the Bombay Company was properly assessed as the agent of the Hongkong Company. Thereafter the Hongkong Company purported to terminate any business connection with the Bombay Company. In respect of the year 1928-29 the Commissioner of Income-tax again assessed the Bombay Company as the statutory agent of the Hongkong Company refusing to believe the evidence as to the severance of the connection between the two companies, and in April 1931 the Commissioner on this basis recovered payment of over 3 lacs of rupees in respect of the assessment of the Bombay Company. A reference was then made to this Court, and in August 1933 this Court held that there was no evidence to justify the Assistant Commissioner in holding that the Bombay Company was the statutory agent of the Hongkong Company. From this decision there was an appeal to the Privy Council but the decision of this Court was upheld. It is, therefore, established that at the time of the original assessment of the Bombay Company there was no evidence to justify such assessment. The Commissioner, however, refused to refund the tax which he had recovered on the alleged assessment, unless a third party guaranteed the payment of any fresh assessment. The Assistant Commissioner in January 1934 set aside the assessment and directed the Income-tax Officer to make a fresh assessment. On 30th January 1934 the Income-tax Officer issued the notice which is referred to in the question raised in this reference. The notice requires the Bombay Company to produce or cause to be produced at the Income-tax Officer's office in Bombay on 15th February 1934 books of accounts of the Hongkong

Trust Corporation Limited, Hongkong, for the year ending 31st December 1927. He also gave notice under Section 23, sub-clause 2 requiring the attendance of the assessee on 15th February 1934. On 15th February 1934 the Income-tax Officer held that as the books had not been produced, the assessee was in default and he therefore made an order of assessment purporting to be to the best of his judgment under Section 23 (4). In that assessment he assessed the Bombay Company at precisely the same figure as that at which they had been assessed in the assessment which this Court had held was not supported by any evidence. The assessee made an application for revision under Section 27 of that order which was stayed pending an appeal to the Privy Council. Later, in September 1934, the assessee applied to this Court for an order under the Specific Relief Act directing the Commissioner of Income tax to repay the sum of over 3 lacs of rupees which he had received as tax and that order was made. As a result of the two appeals the Privy Council held that there was no evidence to justify the original assessment on the ground that the Bombay Company was the statutory agent of the Hongkong Company, but that the Court had no jurisdiction under the Specific Relief Act to order repayment of the tax. In November the appeal to the Assistant Commissioner from the Income-tax Officer's order was rejected. This reference is now made raising the question whether there was any evidence to justify the Income-tax Officer in holding that the books of the Hongkong Company ought to have been produced.

Now Section 22 (4), which is a section dealing with returns for the purposes of income-tax, provides that the Income tax Officer may serve on any person upon whom a notice has been served under sub-section (2) a notice requiring him on a date to be therein specified, to produce or cause to be produced, such accounts or documents as the Income-tax Officer may require. In my opinion, it is clear that the section only relates to accounts or documents which are in the possession, or under the control of, the person making the return. I think, that must be so, because failure to produce accounts or documents not only renders the tax-payer liable to assessment under Section 23 (4) but it also renders him liable under Section 51 to a penalty by way of fine not exceeding ten rupees for every day during which the default continues. It is clear, in my opinion, that the Legislature could not have intended to impose a penalty on a person for non-production of documents which he was, in law, incapable of producing. Now, in the present case, there is not a particle of evidence that the Bombay

Company is in a position to produce or cause to be produced the books of the Hongkong Company. It has been held by this Court and the Privy Council that there is no evidence to show that there is any connection between the two companies and it is not suggested that any further evidence has been obtained by the Income-tax Officer. He says that he has got some confidential information, but as it is not in evidence we do not know what it amounts to. There is no evidence which can justify him in saying that the Bombay Company is in a position to produce the books of the Hongkong Company, which in law is a separate entity, and that being so, in my opinion, the order under Section 22 (4) was not justified and the consequential assessment under Section 23 (4) was also not justified.

I understand that the sum of over three lacs of rupees recovered as tax as long ago as April 1932 is still in the hands of the Commissioner and has not been repaid to the assessee. When the matter was before this Court in August 1934 we passed certain strictures upon the Commissioner's conduct, and the matter was referred to by their Lordships of the Privy Council in the following passages :—

"..... The learned Chief Justice commented with some severity upon that part of the order of the Commissioner which imposed as a condition of refund that a guarantee should be given by Messrs. E. D. Sassoon & Co., saying that the Commissioner must have known perfectly well that he was not justified in imposing as a condition of the refund that a guarantee should be given of some third party for the amount of any fresh assessment. He further observed with reference to the order under Section 23 (4) made by the Income-tax Officer on February 20, 1934, that it was perfectly obvious, and the Income-tax Officer must have known, that it would not be possible for the assesseees to produce within 15 days books of accounts of the corporation in Hongkong or a corporation which according to the finding of the Court had no business connection with the assesseees."

After holding that the Court had no jurisdiction to make an order under the Specific Relief Act, their Lordships then go on to say :

"Their Lordships cannot but agree, however, with the comments made by the learned Chief Justice upon the Commissioner's order of January 16, 1934, imposing as a condition of refund that E. D. Sassoon & Co. Limited should undertake to be responsible for paying back the amount in case an assessment were levied again or

the matter was taken on appeal to the Privy Council. So, too, in the case of the order of the Income-tax Officer dated February 20, 1934, making an assessment in default under Section 23 (4) for failure to comply with the order of January 30, requiring the Bombay Company to produce the Hongkong Company's books of account on February 15, the strictures of the High Court are plainly justified. To this their Lordships will add that the action of the Income-tax Officer in refusing to deal with the application under Section 27 until the disposal of the appeal to His Majesty in Council was equally open to criticism. Whether it adds to or subtracts from the discredit of such proceedings, if it be supposed that the Income-tax authorities considered themselves entitled to do what was necessary to retain the assessee's money until the decision of this Board could be obtained, is a question upon which no opinion need here be ventured. It should suffice now to observe that since August 1934 (1933) (sic), the Income-tax authorities have been withholding from the Bombay Company over three lacs of rupees extracted from them by an illegal assessment order, and that there is no pretence of justice or law in the notion that the money can be withheld in case on some future date a valid assessment may come into existence."

Unfortunately that expression of opinion has not sufficed to induce the Commissioner of Income-tax to do what he ought to have done in August 1933, viz., repay the money. I have made these observations as it seems to me desirable at a time when proposals are being made to amend the Income-tax Act, that the Legislature should consider the desirability of protecting the taxpayer from abuse of authority. As the law stands there appears to be no means of compelling the Income-tax Commissioner to refund tax illegally levied.

The answer to the question of the Commissioner is in the negative. We direct the Commissioner to pay the costs of the assessee on the Original Side scale.

KANIA, J.—I agree. The short point which requires consideration, to answer the question raised in the reference, is the consideration of Section 22 (4) of the Indian Income-tax Act. In my opinion, that section does not entitle the Income-tax authorities to demand the production of books which are neither the books of the assessee or under their control. In the present case the Bombay Company, which is a limited company, was alleged to be the statutory agent of the Hongkong Company, which is another limited company. The Bombay Company is not proved, on

evidence, to be the statutory agent of the Hongkong Company. In law, the two companies are different entities. I do not see any justification for the Income-tax authorities calling upon the Bombay Company to produce the books of the Hongkong Company and in default to suffer the consequences provided in Section 23 (4). The utmost which can be stated, on the allegations or statements found in the reference, is that the two companies may be called friendly. There appears, however, no justification in law, on that account, to call upon one friend to produce the books of another and in default to make the party called upon liable under Section 23 (4). On that ground I think the question should be answered as suggested by the learned Chief Justice.

[IN THE RANGOON HIGH COURT]

ABBA DADA AND COMPANY

v.

COMMISSIONER OF INCOME TAX, BURMA.

SIR E. GOODMAN ROBERTS, C. J., and DUNKLEY, J.

April 6, 1938.

FIRM—APPLICATION FOR REGISTRATION—ALLEGATION OF GIFT TO SONS AND EMPLOYEES AND RE INVESTMENT BY THEM IN BUSINESS AS PARTNERS—NO REGISTERED DEED OF GIFT—POWER OF INCOME TAX OFFICER TO REFUSE REGISTRATION—REFERENCE—QUESTIONS NOT RAISED BEFORE COMMISSIONER—CANNOT BE RAISED UNDER SECTION 66 (3)—INCOME TAX ACT, SECTIONS 26A and 66 (3).

When the assessee, a Mahomedan residing in Burma, was about to be assessed to income tax he made an application to the Income Tax Officer under Section 26-A of the Income Tax Act for registration of his business as the business of a firm alleging that he had made gifts of Rs. 75,000 to each of his two sons and Rs. 5,000 to two of his employees and that these sums had been re-invested by these four persons in the business which had thereby become the business of a firm of 5 partners. There was no deed registered under the Registration Act but there was a deed of partnership specifying the shares of the partners and entries in the books to support these allegations. The Income Tax Officer found that no real firm existed and refused registration as a firm: Held, (i) that

inasmuch as in Burma a gift of property by one Mahomedan to another must be made in accordance with Section 123 of the Transfer of Property Act, and inasmuch as the gifts comprised immoveable property also, there were no valid gifts to the sons and the employees and the business could not be registered as that of a firm; (ii) that the case raised the important question whether when an application under Section 26A of the Act is made in proper form and a deed of partnership is produced with the application, the Income-tax Officer has jurisdiction to refuse to register the partnership under Section 26A and the rules thereunder either peremptorily or after giving the assessee an opportunity to be heard; but (iii) as the assessee did not in his application under Section 66 (2) ask the Commissioner to refer this question of law, the High Court had no power to require him to state a case on this point.

Cases referred to :

BISSESWARLAL BRIJLAL v. COMMISSIONER OF INCOME-TAX, BENGAL [1930] (4 I.T.C. 365 ; 57 Cal. 1336).

COMMISSIONER OF INCOME TAX, BURMA v. C. P. L. E. CHETTIAR FIRM [1934] (1934 I.T.R. 201 ; 12 Rang. 322).

MA ASHA v. B. K. HALDAR [1936] (I.L.R. 14 Rang. 439).

Application for a mandamus under Section 66 (3) of the Income-tax Act, requiring the Commissioner of Income-tax to state a case and refer it to the High Court.

Civil Miscellaneous Application No. 22 of 1938.

Pagam for the Applicant.

U Thein Maung for the Respondent.

JUDGMENT.

DUNKLEY, J.—When Haji Abba Dada was about to be assessed to income-tax for the year 1936-37 he made an application to the Income-tax Officer, under the provisions of Section 26-A of the Income-tax Act and the rules framed thereunder, for the registration of his business as the business of a firm for the purposes of the Act. Haji Abba Dada alleged that he had made gifts of Rs. 75,000 to each of two sons and had given a bonus of Rs. 5,000 to each of two employees, out of the capital of his business, and that these sums had been re-invested by these four persons in the business, which had thereby become a partnership of five persons. He produced a deed of partnership dated the 29th April 1936, which was not registered under the provisions of the Registration Act, and a certificate of

registration of this partnership under Section 59 of the Partnership Act, and pointed to entries in the books of account which purported to show that the capital of the new partnership was divided into five shares—one and a half lakhs for himself, Rs. 75,000 for each of his two sons, and Rs. 5,000 for each of the two employees. The Income-tax Officer held some sort of an enquiry and came to the conclusion that no real firm existed, and therefore refused to register the firm under Section 26-A. An appeal against this order was made to the Assistant Commissioner of Income-tax, but was dismissed. The application was made to the Commissioner of Income-tax to refer certain questions of law, which, the assessee alleged, arose out of the appellate order of the Assistant Commissioner, to this Court, but the Commissioner of Income-tax declined to state a case. Hence this present application to this Court, under Section 66 (3) of the Income-tax Act, asking us to require the Commissioner to state a case.

The order of the Commissioner of Income-tax, dated the 16th November 1937, is based mainly on surmise and speculation, and we do not propose to make any further reference to it, save that we must take strong exception to one statement occurring in the order, where, referring to an application of the assessee that his assessment should be made at Rangoon instead of at Myamaung, the Commissioner says that this application was "made, I should guess, in the interests of his professional representative." This statement is entirely without foundation in fact, was quite unnecessary and highly improper.

It is admitted that the application by the assessee under Section 26A was made in proper form and in accordance with the rules. It was accompanied by a deed of partnership, which was not registered under the Registration Act, but which purported to specify the individual shares of the partners. There were also produced the book entries in the books of account purporting to set out the shares in the capital of each of the partners, and the registration certificate of the firm under the Partnership Act. No other facts were alleged to prove, as SIR GEORGE RANKIN, C.J., put it in *Messrs. Bissessarwal Brjial v. The Commissioner of Income-tax, Bengal*, (4 I.T.C. 365) "the reality of the instrument produced", but Mr. Paget for the assessee now says that other evidence was available and would have been produced if opportunity had been given.

The assessee asked the Commissioner of Income-tax to refer six questions to this Court. It is unnecessary to set out these

questions in full, and it is sufficient to say that in essence they amount to the single question whether there was contributions validly made to the capital of the alleged partnership by the two sons and the two employees. It is common ground that these four persons had no means of their own wherewith to make contributions to the capital, and that all that has occurred is that certain entries, which may well have been made by a clerk, have been made in the account books of the business formerly belonging to Haji Abba Dada alone, giving them credit to their respective shares in the capital of the business. Admittedly no cash or property ever passed, but it is set up that these entries in the books of account and the execution of the partnership deed amount to gifts by Haji Abba Dada to each of these persons of these respective amounts which were at the same time contributed by these persons to the capital of the firm.

Any question of law which might arise out of these circumstances has already been answered by a Full Bench of this Court in *Ma Asha and Others v. B. K. Haldar*, (14 Rang. 439) where it was held that in Burma a gift of property by one Mahomedan to another must be made in accordance with the provisions of Section 123 of the Transfer of Property Act. There were no valid gifts by Haji Abba Dada to his sons and employees, and hence there have been no contributions by them to the capital of the alleged partnership. Moreover, the capital of this business consists mainly of immoveable property, and the partnership deed purported to transfer this capital from one person, Haji Abba Dada to five persons, Haji Abba Dada, his two sons, and his two employees. As it has not been registered under the Registration Act, it was clearly ineffectual to do anything of the kind. Therefore four of this alleged partners have not acquired any share in the capital of this business. Mr. Paget has urged that it is unnecessary to the constitution of a partnership that all the partners should hold a share in the capital of the firm; that is undoubtedly so, but in order that a firm may be registered under Section 26-A of the Income-tax Act the instrument of partnership must specify the individual shares of the partners, and the instrument in this case specifies that each partner holds a share which in actual fact he does not hold, and therefore the firm cannot be registered under the section.

In our opinion, a question of law does arise from the appellate order of the Assistant Commissioner and that is this;—

“Whether, when an application under Section 26-A of the Income-tax Act is made in proper form and a deed of partnership is produced with the application, the Income-tax Officer has jurisdiction to refuse to register the partnership under Section 26A and the rules thereunder, either peremptorily or after having given the assessee an opportunity of being heard”.

There is no decision of this Court on this important point, and the provisions of the section and rules are by no means clear, and therefore we should have been prepared to require the Commissioner of Income-tax to refer this question if we had jurisdiction to do so. But clearly we cannot require him to refer it; this has been decided in *The Commissioner of Income-tax, Burma v. C.P.L.E. Firm*. In his application under Section 66 (2) the assessee did not ask the Commissioner of Income-tax to refer this question of law : no doubt advisedly, as the question is covered by authority of Indian High Courts. Consequently it is not open to us to require the Commissioner to state a case on this point.

This application fails and is dismissed with costs. Advocate's fees ten gold mohurs.

GOODMAN ROBERTS, C. J.—I agree.

[IN THE LAHORE HIGH COURT.]

M. AND D. AMINOFF

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON, J., and DIN MOHAMMAD, J.

January 25, 1938.

REFERENCE—APPLICATION TO HIGH COURT UNDER SECTION 66 (3) TO REQUIRE COMMISSIONER TO STATE CASE WITHOUT APPLYING TO COMMISSIONER UNDER SECTION 66 (2)—MAINTAINABILITY—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 66 (1), (2), (3).

An application under Section 66 (3) of the Indian Income Tax Act to require the Commissioner to state a case can be made only if an application under Section 66 (2) has been previously made to the Commissioner himself to refer the case and he has refused to do so. Where the assessee did not prefer an appeal to the Assistant Commissioner or an application to the Commissioner under Section 66 (2)

but only made an application to the Commissioner under Sections 33 and 66 (1): Held, he was not entitled to make an application to the High Court under Section 66 (3).

Civil Miscellaneous No. 662 of 1937.

Petition under Section 66 (3) of the Income-tax Act, requiring the Commissioner of Income-tax, Punjab, North West Frontier and Delhi Provinces, Lahore, to state and refer a case on certain questions of law, to the Lahore High Court.

Norman Edmunds and Kirpa Ram Bajaj for the Assessee.

S. M. Sikri and J. N. Aggarwal for the Commissioner.

JUDGMENT.

This is an application by an assessee under sub-section (3) of Section 66 of the Income-tax Act. A preliminary objection has been raised by respondent that this application is incompetent on the ground that an application under sub-section (3) of Section 66 can be made to the High Court only if an application under sub-section (2) of Section 66 is previously made to the Commissioner and that where no such application has been made by an assessee, he cannot move the High Court under sub-section (3) of Section 66. The material portions of the relevant provisions of law read as follows:—

Sub-section (2) of Section 66: "Within sixty days of the date on which he is served with notice of an order under Section 31 or Section 32 or of an order under Section 33 enhancing an assessment or otherwise prejudicial to him 'or of a decision by a Board of Referees under Section 33-A, the assessee in respect of whom the order or decision was passed may, by application.....require the Commissioner to refer to the High Court any question of law arising out of such order or decision.....".

Sub-section (3) of Section 66: "If on any application being made under sub-section (2) the Commissioner refuses to state the case on the ground that no question of law arises, the assessee may apply.....to the High Court.....".

It would appear, therefore, that before an assessee can put in an application to the High Court under sub-section (3), it is incumbent upon him to apply to the Commissioner under sub-section (2) of Section 66. That he can do only if an order in respect of the assessment complained of is made under Section 31 or Section 32, or if an order under Section 33 enhances the assessment made on him or is otherwise prejudicial to him, or if a Board of Referees decides any question relating to his assessment under Section 33A.

Where none of these conditions exists, no application under sub-section (2) of Section 66 is competent, and consequently sub-section (3) of Section 66 does not come into play at all.

In the present case it is admitted on behalf of the assessee that no appeal was made to the Assistant Commissioner, nor was an application under sub-section (2) of Section 66 made to the Commissioner. All that the assessee did was to make an application to the Commissioner under Section 33 along with sub-section (1) of Section 66. The Commissioner while rejecting the assessee's application neither enhanced his assessment nor did he make any order prejudicial to him under Section 33. Clearly, therefore, no application under sub-section (2) of Section 66 could be made to the Commissioner and none was actually made. This being so, the present petition under sub-section (3) of Section 66 is competent.

No authority is needed for this obvious proposition of law but reference may be made to 4 I.T.C. 324, 2 I.T.C. 430 and 2 I.T.R. 339. Those judgments, though not exactly in point, support the conclusion arrived at above.

We accordingly dismiss this application with costs.

[IN THE PATNA HIGH COURT].

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA

v.

RAJA BAHADUR DHAKESHWAR PRASAD NARAIN SINGH

WORT, A.C.J. and DHAVLE, J.

April 28, 1938.

INTEREST—PURCHASE OF DECREE IN CONSIDERATION OF ZARPESHGI LEASE FOR FIXED TERM—INTEREST ON ZARPESHGI AMOUNT TAKEN INTO ACCOUNT IN FIXING PERIOD—SUCH INTEREST, WHETHER CAN BE SET OFF AGAINST INTEREST ACCRUING DUE ON DECREE—EXPENDITURE INCURRED TO EARN INCOME—INDIAN INCOME TAX ACT (XI OF 1922), SECTIONS 10 (2) (ix), 12 (2).

The Maharaja of Darbhanga had obtained a decree against the Tekari Raj for Rs. 33,00,000 carrying future interest at 6 per cent per annum. The assessee obtained an assignment of this decree for Rs. 31,54,936. He executed a hand note for Rs. 1,04,936 and for the balance of the price, viz., Rs. 30,50,000 he gave to the Maharaja a Zarpeshgi thika lease of certain immoveable properties for a period

of 17 years. The amount of 17 years was fixed so that the principal and interest due may be wiped off at the end of the period by enjoyment of the rent and profits. The assessee claimed that he should be allowed to set off against the interest which accrued due under the decree interest on the Zarpeshgi amount which was taken into account in fixing the period of 17 years and which must be deemed to have been paid to the Maharaja in the shape of rent and profits : Held, on a reference by the Commissioner, that, although interest on the Zarpeshgi amount might have been taken into account in fixing the period of 17 years, the assessee was not legally liable to pay any interest and there was in fact no payment of interest. The assessee had only purchased an asset producing taxable income, namely the decree, in exchange for non-taxable income, and the deduction claimed was not allowable under Section 10 (2) (ix) or Section 12 (2).

Case stated by the Commissioner of Income-tax, Bihar and Orissa under Section 66 (2) of the Indian Income Tax Act, 1922. [Mis Jud. Case No. 14 of 1937]. The Statement of Case was as follows :—

“I have the honour to refer the following case for the decision of the Honourable the Judges of the High Court under Section 66 (2) of the Indian Income-tax Act (XI of 1922) hereinafter referred to as the Act).

2. Raja Bahadur Dhakeshwar Prasad Narain Singh (hereinafter referred to as the petitioner) is the head of a Hindu undivided family and has been assessed by the Income Tax Officer, Patna, under the following heads of income :—Property, Business, Other sources.

3. The present reference arises out of the inclusion in the assessment for the year 1932-33 (previous year 1338F) of a sum of Rs. 1,96,815 (reduced on revision by the Commissioner to Rs. 41,003) under the head “Business” (Money-lending) by the Assistant Commissioner, Central Range, Patna, under Section 31 (3) (a) of the Act.

4. The petitioner showed in his return of income a net loss of Rs. 70-12-3 from money-lending but the Income-tax Officer computed the profit to be Rs. 55,681 and assessed it accordingly. The method of computation of the profit adopted by the Income tax Officer is that described in paragraph 5 of the Assistant Commissioner's appellate order. This method of computing the petitioner's money-lending income had been objected to by the petitioner in connection with 1931-32 assessment and the matter

was eventually taken to the High Court where it was decided against the petitioner (4 I.T.R. 72). In arriving at his figure of profit, the Income-tax Officer excluded the interest accrued on the decree held by the Maharajadiraj of Darbhanga against the Tekari Raj which had been purchased by the petitioner in June 1931, on the ground that as the consideration for the purchase price of the decree was met partly by the grant of the petitioner's landed property on *Ijara Patti* "Zarpeshgi thika lease" to the Maharajadhiraja for a period of 17 years, and partly by the execution of a hand-note, no actual income accrued to the petitioner out of the transaction. The facts relating to this decree are as follows :—

A decree was obtained by the Maharajadhiraja of Darbhanga against the "nine annas" Tekari estate. This decree was for Rs. 33,85,181 bearing interest at 6 per cent per annum. The decree was purchased by the petitioner for a consideration of Rs. 31,54,936 which was paid by a hand note (although the assignment deed shows that it was to be paid in cash) for Rs. 1,04,936 and for the balance of Rs. 30,50,000 the petitioner executed on 15th June 1931 a "Zarpeshgi thika lease" of his Amanwan property yielding an annual income of over Rs. 3,60,000, for 17 years in favour of the Maharajadhiraja of Darbhanga. According to this lease deed the Maharajadhiraja was to be in possession and enjoyment of the leased properties for the said period of 17 years subject to the payment of a nominal lease rent of Rs. 10,000 and that after the close of that period the leased properties were to be given back to the petitioner. A copy of the "Zarpeshgi thika lease" is filed and an extract from a statement showing liquidation of the Darbhanga mortgage decree by Zarpeshgi of Amanwan Raj Property" is also filed.

5. The Assistant Commissioner of Income-tax did not agree with the finding of the Income-tax Officer in regard to the assessability of the interest accrued on the decree. He therefore served upon the petitioner's representative a notice to show cause why the tax should not be enhanced by including in the assessment the accrued interest in respect of the decree against the Maharaja Kumar of Tekari. In response to this notice the petitioner submitted his explanation in writing in which he contended (a) that he received no interest on the decree, (b) that no income accrued to him and that reference to the accrued basis in the Assistant Commissioner's notice was irrelevant when in fact there was no income and (c) that the petitioner acquired the Darbhanga decree

with the help of borrowed money raised by means of the handnote for Rs. 1,04,936 and the "Zarpeshgi thika lease" for Rs. 30,50,000 and the interest payable on such borrowings is an amount equal to the interest receivable on the decree against which it should be set off. The Assistant Commissioner after giving the petitioner an opportunity to be heard enhanced the assessment by including therein one year's accrued interest, amounting to Rs. 2,03, 111 on the decree and allowing a set off of the interest for one year, amounting to Rs. 6,296 payable on the sum of Rs. 1,04,936 which was the amount of the handnote given as part of the price for the purchase of the decree. He declined to allow any set off by way of interest or otherwise in respect of the transaction entered into by the "Zarpeshgi thika lease".

6. The petitioner, being dissatisfied with the Assistant Commissioner's order of enhancement, filed an appeal under Section 32 of the Act before my predecessor who disallowed his contention and dismissed the appeal. Later, my predecessor revised the assessment under Section 33 reducing the net income from the Darbhanga mortgage decree to Rs. 41,003 by taking interest for $2\frac{1}{2}$ months only on the decree and the handnote, as the date from which such interest accrued due to be received and paid respectively by the petitioner was 15th June 1931 which was only $2\frac{1}{2}$ months from the close of the petitioner's year of account.

7. The petitioner now requires me under Section 66 (2) of the Act to refer to the High Court the question of law said to arise out of the disallowance of the deduction claimed in respect of interest on the "Zarpeshgi thika lease". The petitioner's counsel agrees to the question being stated as follows :—

"Where the petitioner in part consideration for the assignment of a mortgage decree gives a "Zarpeshgi thika lease" of agricultural lands for a period of 17 years, whether he is entitled to set off against the interest realisable on the decree any amount by way of interest in respect of the "Zarpeshgi thika lease"?

8. The petitioner's contention is that the sum of Rs. 30,50,000 covered by the "Zarpeshgi thika lease" must be regarded as a loan bearing interest at 6 per cent per annum. It is claimed that the "Zarpeshgi thika lease" is more or less a usufructuary mortgage. If it were a simple mortgage there would be no question of the interest payable thereon being allowable. It is argued therefore on behalf of the petitioner that the mere fact that the mortgage takes the peculiar

form of a "Zarpeshgi thika lease" or something in the nature of a usufructuary mortgage makes no material difference. The amount of interest claimed as a deduction is the interest on Rs. 30,50,000 for $2\frac{1}{2}$ months, that is Rs. 38,125.

9. In my humble opinion the arguments advanced for the petitioner are not sound. It is not correct to say that the petitioner obtained a loan of the sum of Rs. 30,50,000 on which interest is payable. The sum, I venture to submit, should be regarded as the price fixed for the present value of the user of the agricultural properties covered by the "Zarpeshgi thika lease" for a period of seventeen years, subject to the payment of the nominal annual lease rent of Rs. 10,000 reserved by the lease. By the series of transactions with the Maharajadhiraja of Darbhanga the petitioner surrendered for a period of 17 years an agricultural source of income subject to a nominal lease rent of Rs. 10,000, which even was not receivable by him in cash and acquired in its place a new source of income, that is the Darbhanga mortgage decree. In other words, the petitioner had exchanged a non-assessable source of income (his Amawan property) for an assessable source of income (the mortgage decree). In such circumstances, I submit that no question can possibly arise of any set-off of interest in respect of the "Zarpeshgi thika lease" against the interest receivable on the decree. As a matter of fact the "Zarpeshgi thika lease" makes no provision whatsoever for the payment of any interest. No doubt the interest factor enters into the computation of the period for which the lease should run, but the interest so calculated is strictly speaking not interest at all. It is certainly not interest in the hands of the Maharajadhiraja who is supposed to receive it. It is part of the agricultural income that he derives from the lands, see *Commissioner of Income-tax, Bihar and Orissa v. Maharajadhiraja Kameshwar Singh of Darbhanga* (3 I. T. R. 305 Privy Council decision) and *Rai Bahadur Dalip Narain Singh v. Commissioner of Income-tax, Bihar & Orissa* IX I.T.C. 222. If it is not interest in the hands of the Maharajadhiraja, it naturally follows that it cannot be said to be interest paid by the petitioner. I, therefore, submit that the question referred for the decision of the Honourable the Judges of the High Court should be answered in the negative

S. M. Gupta, for the Commissioner.

Dr. Sir Sultan Ahmed, P. R. Das, S. N. Roy and S. K. Masumdar for the Assessee.

JUDGMENT.

WORT, A. C. J.—This is a case stated by the Commissioner of Income-tax in the following terms: "Where the petitioner in part consideration for the assignment of a mortgage decree gives a '*Zarpeshgi thika* lease' of agricultural lands for a period of 17 years, whether he is entitled to set off against the interest realisable on the decree any amount by way of interest in respect of the '*Zarpeshgi thika* lease'? The limitation of this question is to be noted. I make reference to that fact by reason of the suggestion, which was put forward towards the end of the argument, that there was at any rate a possibility that the assessee was entitled to deduct not merely the interest as stated in the question, but a portion of the actual income realised by the vendor of this decree from the mortgaged properties. That point does not arise on the form of the question stated by the Commissioner.

It is necessary to state briefly the facts. The Income-tax Officer assessed the assessee (the applicant before this Court) for a sum of Rs. 1,08,037. This amount was increased by the Assistant Commissioner by a sum of Rs. 1,59,042, making a total assessable income of Rs. 2,67,079. The ground for that increase arose by reason of the following facts.

The Maharajadhiraja of Darbhanga had obtained a decree for a sum of upwards of Rs. 33,00,000. This decree was assigned to the assessee for a consideration of Rs. 31,54,936. The payment of the consideration was by way of a hand-note executed by the assessee for Rs. 1,04,936, the balance of Rs. 30,50,000 being liquidated by the execution of a *thika* or *zarpeshgi* lease by the assessee in favour of the Maharaja for a period of seventeen years. At the time of entering into the transaction the parties agreed upon an account. The account took the form of a statement of the principal, a calculation of interest (quarterly), an addition of this interest to the principal and the deduction therefrom of the quarterly realisations of rents and profits from the *zarpeshgi* property. Each quarter the net arrears so called were entered and that amount under the form of accounting adopted necessarily diminished as time went on until completely wiped out at the end of the third kist of the seventeenth year. It is this quarterly interest which the assessee claims to have deducted from his income for the purposes of calculating his assessable income under the Income-tax Act. It is to be noticed that the only certain figure, although the account is agreed, is the first statement of principal and the first

statement of interest as the realizations are merely an estimate and must necessarily be so in the circumstances.

The Commissioner in the case has stated that the interest so called was not interest at all as it was not interest in the hands of the Maharajadhiraja as he did not receive the amount but the item was a mere calculation for the purpose of ascertaining the period of occupation. The argument put forward by Sir Sultan Ahmed is certainly an attractive one, but in my judgment is one which cannot be supported.

His first and substantial contention is that the fact that the transaction was a *sarpeshgi* lease involved his liability for interest and that liability for interest was the cost to him of the income which he was to derive from the decree which he has purchased. In the first instance there seems to be a fallacy underlying this statement. It is true that in preparing his accounts, as the assessee does on the mercantile system, he is chargeable to income-tax on the six per cent. which he is supposed to derive from this decree so long as he does not put it into execution, but it is obvious that so soon as the decree is executed the income as represented by six per cent. per annum disappears. The fallacy lies in the statement that the *sarpeshgi* lease was for the purchase of this income. In point of fact the purchase was not for the income of the decree but the purchase of the decree itself.

Now, the question to be answered depends entirely upon, what is the nature of this interest which the assessee claims to be deducted? The Commissioner as I have already stated, points out that it is not income in the hands of the Maharaja, and he appears also to be of the opinion that it is not an expenditure on the part of the assessee. The substance of the transaction was that, for the purchase of the decree, or, to put it in the form of the argument which has been addressed to us, for the purchase of this taxable income represented by the six per cent. which the assessee is deriving from the decree at the present moment, the assessee relinquished non-taxable income, being of course the rents and profits and subject-matter of the *sarpeshgi* lease. Now, it might have been argued—but it is an argument which as I have said is irrelevant for the purposes of this case having regard to the form of the question—that the expenditure within the meaning of either sub-section (ix) of Section 10 (2) or sub-section (2) of Section 12 was the income from the rents and profits or the income from the *sarpeshgi* property which, by handing over to the Maharaja, the assessee had lost. But neither was that argument put forward

seriously, nor as I have said could it be put forward seriously in this case.

The question therefore arises, as I have already stated, what is this interest chargeable in the account? In fact the interest is nothing more than an arithmetical calculation entered into by the parties for the purpose of ascertaining the period of occupation of the vendor the Maharaja at the end of which he would reimburse the amount of the consideration being the purchase price of this decree. Although the account may disclose items of interest, it is impossible in the circumstances to say that it is a liability of the assessee. It is not a payment which he is to make, nor is it a sum for which he could be sued. I have stated that the interest is nothing more than a method of calculation of the period for which the Maharaja held the property. It is not contended that, had the property been handed over to the Maharaja absolutely, any deduction whatsoever could be made. It would indeed be nothing more than a capital expenditure within the meaning of sub-section (2) of Section 12. The question arises whether the fact that the property was placed in the hands of the Maharaja for a limited period would make any substantial difference to the proposition which I have stated. In my judgment it would not. In substance this is nothing more than a capital expenditure over a period of seventeen years. I have already pointed out and repeat, for fear that there might be any misunderstanding of my statement, that we are not actually concerned with any question of deduction of the income to be derived from this property as an expenditure within the meaning of the section. It being impossible under any circumstances to contend that that sum could be deducted, it seems to me necessarily to follow that a sum by way of interest or, to put in other words, an item in the account which is described as 'interest' merely for the purpose of ascertaining the period over which the property should be held, could not be deducted either.

In my judgment the opinion of the Commissioner in this case that this is not interest chargeable to the assessee and therefore not an expenditure within the meaning of Section 10 or Section 12 is correct. I would therefore answer the question submitted to the Court in the negative.

The Crown is entitled to costs; hearing fee ten gold mohurs.

DHAVLE, J.—The assessee claims to be entitled to set off against the interest realizable on the decree the amounts that were shown as interest in the accounts that were made up between the

assessee and the Maharajadhiraja as a preliminary to the execution of the *zarpeshgi thika* lease; and he makes this claim on the footing that the latter is expenditure incurred by him solely for the purpose of earning the former. But the accounts that were agreed to between the parties on that occasion were merely *pro forma* accounts. As the Commissioner of Income-tax has observed: "No doubt the interest factor enters into the computation of the period for which the lease should run". Those accounts only show how the period of seventeen years for the *zarpeshgi thika* lease was arrived at, but it is impossible to contend that they impose any separate liability upon the assessee for the payment of any interest to the Maharajadhiraja. There is no dispute that interest as matter of fact is not actually mentioned in the *zarpeshgi thika* lease.

Sir Sultan Ahmed has strenuously contended that the matter should be governed even more by the form than by the substance, but this contention had reference to the fact that the arrangements between the assessee and the Maharajadhiraja took the form of a *zarpeshgi thika* lease. It is urged that interest is of the essence of such a lease and is therefore necessarily implied in it. But payment of interest may be contemplated and yet there may be no interest actually paid or received in the case of such arrangements. The period is fixed on the basis of a certain assumed income from the property mortgaged, but the *zarpeshgidar* takes the risk of the seasons and apart from the lease itself, there is no liability imposed on the mortgagor for the payment of any interest. Nor is it altogether correct to say that by means of this *zarpeshgi thika* lease the assessee purchased the interest on which the Income-tax Department endeavoured to assess him.

The consideration that flowed from the Maharajadhiraja to the assessee in return for this *zarpeshgi thika* lease is the decree for Rs. 33,00,003 and odd. This decree, it is true, carried interest at 6 per cent; but it is indisputable that the assessee would not be entitled to any interest at all under the assignment from the Maharajadhiraja the moment he succeeds in realising in full the decree assigned to him. The *pro forma* accounts agreed between the parties as a preliminary to the *zarpeshgi* assumed interest as payable by the mortgagor and assignee of the decree for a period of 17 years; but it cannot be said that they assumed interest on the decretal amount for that or any other fixed period. What the assignee paid for was the decree and there was no question of his paying for the incalculable amount of the interest that may

fall due on the decretal amount. It cannot therefore be said within the meaning of clause (ix) of Section 10 (2) or sub-section (2) of Section 12 that there was any interest in the *sarpeshgi thika* lease which could be regarded as expenditure incurred solely for the purpose of earning any interest on the decree assigned to the assessee by the Maharajahdiraja.

Question answered in the negative.

[IN THE PATNA HIGH COURT].

SHEOSAHAYAMAL HIRALAL

v.

COMMISSIONER OF INCOME TAX, BIHAR & ORISSA.

WORT, A. C. J. and DHAVLE, J.

April 29, 1938.

BAD DEBT—COMPOSITION WITH CREDITORS—WHEN BALANCE UNPAID BECOMES BAD—FAILURE TO INCLUDE INTEREST IN RETURN FOR SUBSEQUENT YEARS—EFFECT.

In the year 1930 the assessee took over all the assets of one of his debtors and paid 8 as. in the rupee to the other creditors. He suffered a loss of Rs. 1,600 on this account and claimed in his assessment for the year 1934-35 that this amount should be written off as a bad debt. The Commissioner found that by the payment of 8 as. the debtor was released from all liability. Interest on the sum of Rs. 1,600 was also not returned after the year 1930 though the assessee kept the accounts on the mercantile system : Held, that in the circumstances the debt became a bad debt in 1930 and the assessee was not entitled to claim a deduction of the same in 1934-35.

In the matter of an application under Section 66 (3) of the Indian Income-tax Act, 1922 (XI of 1922) by Sheosahayamal Hiralal of Soro, district Balasore, in respect of his assessment to income-tax, for the year 1934-35.

Statement submitted to the High Court in compliance with its order, dated the 4th February, 1937, in M.J.C. No. 3 of 1936 :—

“This statement is confined solely to the point in respect of which the High Court, in its order referred to above, directed me to state a case. It will be convenient to recapitulate briefly the facts and circumstances bearing on the point.

2. The assessee was assessed for the assessment year 1934-35 (accounting year *Dewali* 1939-90) on a total income of Rs. 11,615.

In this amount was included a sum of Rs. 1,600 being a debt due by one Joharmal Bhagwandas which was claimed by the assessee as a bad debt but which was disallowed by the Income-tax Officer. The reasons for the disallowance are stated in the statement order as follows :—

“Of the bad debts claimed, Rs. 1,600 relates to Joharmal Bhagwandas. On 27-10-30 assessee, who was his main creditor took over his assets and liabilities, cleared off the liabilities on compromise and appropriated the assets towards his dues (vide accounts of 1987-88). If the result was any loss, it was such of 1987-88 and not of the previous year 1989-90.”

The assessee disputed the disallowance of this bad debt in this appeal to the Assistant Commissioner, but the latter upheld the disallowance in the following words :—

“The bad debt due from Joharmal Bhagwandas appears to have been rightly disallowed. All that could possibly be had from this debtor having been realised on 27-10-30, the assessee had no justification for keeping the accounts open till the year 1989-90. The debt, as I find, really became bad in the year 1987-88.”

Thereupon the assessee filed an application under Sections 33 and 66 (2) before the Commissioner ; but my predecessor by his order, dated the 15th February 1936, rejected the application. The following is a relevant extract from his order :

“The facts relating to the letter are as follows : This debtors became very heavily indebted and in 1930 his creditors apprehending that Joharmal Bhagwandas was trying to abscond without satisfying his creditors made a raid on his shop. Learning this, the assessee who is the principal creditor arrived on the scene, arrived at an undertaking with the other creditors, took over all the assets of the debtor, agreed to pay 8 as for the other dues and released the debtor of all further liabilities. The transaction was completed in 1930 and resulted in a loss of Rs. 1,6000 to the assessee. Now all this took place in 1930 and undoubtedly the unrealisable balance, in the circumstances, became bad in that year. The assessee has given no reason why he claims deduction of the loss against the profits of the year ending *Dewali* (October) 1933. It was rightly disallowed by the Assistant Commissioner. On this point the assessee has asked to refer the following question under Section 66 (2) of the Act :

“When a debt from a party, not yet insolvent or bankrupt, is written off at the time of being barred by limitation, is it too late to be allowed as a deduction ?

"This question or a similar question has been answered by the Privy Council in the case of *Sir S. M. Chitnavis*, and there is no obscurity in the legal position. I refuse to refer the question".

The assessee then filed an application under Section 66 (3) before the High Court and in pursuance of that application the High Court, on the 4th February 1937, passed the following order :—

"It is contended by Mr. Jayaswal on behalf of the assessee that whereas the Commissioner purports to find as a fact that the debt by Joharmal Bhagwandas to the assessee of Rs. 1,600 was wiped off and extinguished in the year 1930, that in fact the assessee has been charged interest accruing on such debt since 1930. In order therefore to see whether the debt was in law extinguished on this date, it is necessary to call upon the Commissioner to state whether in fact in respect of this debt the assessee has been assessed to income-tax in respect of the accrual of interest on this debt, it being not clear how the debt can be treated as having been wiped off in 1930 if interest is to be treated as having accrued since that date on the debt."

3. The facts have been investigated by reference to the relevant assessment records. The position is that, in the assessment for 1931-32, 1932-33 and 1933-1934, estimates were made for accrued interest on trade debts not disclosed by the assessee on his books, but there is nothing to show that accrued interest on the debt of Rs. 1,600 due by Joharmal Bhagwandas was included in the estimates. While other debts were specifically mentioned in framing the estimates, no mention was made of this particular debt. So far as the records show, therefore, the assessee has not been assessed to income-tax in respect of the accrual of interest on this debt since 1930. It is for the assessee to prove that he has been so assessed. It is clear that he is unable to do so, and, in the circumstances, I submit that he must fail on this point.

Mrs. Dharmasila Lal and *G. G. Das*, for the assessee.

S. M. Gupta, for the Commissioner.

JUDGMENT.

WORT, A. C. J.—This is a case stated by the Commissioner of Income tax under the order of this Court, dated the 4th of February 1937. The question required to be stated was "Whether in fact in respect of this debt the assessee has been assessed to

income-tax in respect of the accrual of interest on this debt it being not clear how the debt can be treated as having been wiped off in 1930 if interest is to be treated as having accrued since that date on the debt". In my statement I am paraphrasing the question put by the Chief Justice and James, J.

The facts are that assessment was first of all made by the Income-tax Officer of a sum of Rs. 11,615 which was reduced by the Assistant Commissioner to Rs. 10,164. At all material times the assessee wished to deduct from the total assessable income a sum of Rs. 1,600 the debt owing by one Jorharmal Bhagwandas. It appears from the facts stated by the Commissioner that in the year 1930 the present assessee with a number of his other co-creditors seized the property of Joharmal and paid themselves to the extent of 8 annas in the rupee. According to the order of the Commissioner made on the 15th of February 1936, by which he rejected the assessee's petition to state a case, this transaction under which the creditors paid themselves 8 annas in the rupee released the debtor from all further liability. This statement was repeated by the Commissioner on the 30th July 1937 in the case stated by him on that date, the case which we have before us in this application. There was a further fact which must be mentioned for the purpose of noting the position of the matter. It is a finding by the Commissioner that the assessee prepares his account on the mercantile system. That being so, and there being no return of interest accruing on debts unpaid, the Income-tax authorities had assessed the assessee with regard to those items in a sum of Rs. 1,000. I repeat, because it seems to me to be conclusive of the matter, that the assessee himself made no return of interest on debts unpaid. It was on the assumption, that income-tax was being paid year by year on interest accruing on debts unpaid, and I presume on the assumption also that amongst those items of interest was an item of interest on this debt of Rs. 1,600 that this Court ordered the Commissioner on the 4th February last year to state a case. But the facts are, as I have already said, that the assessee made no return of interest with regard to this Rs. 1,600. The question therefore strictly does not arise.

There seems to be two answers to the assessee's argument with regard to this matter: the first is the finding of the Commissioner that by the taking over of the debts of Bhagwandas in 1930 the liability of that person (the debtor) was wiped out, and that the assessee had no further rights with regard thereto. If that correctly states the fact, then the question whether the debt became statute

barred in the year of assessment does not arise. It ceased to be a liability in 1930 and became a bad debt from the point of view of the assessee in that year, and, if he wished to take it into account in preparing his account for income-tax purposes, it should have been treated as a bad debt in that year. The second answer is that there was no return of interest with regard to the debt of Rs. 1,600. That being the state of affairs it cannot now be contended that the debt was alive between the year 1930 when this arrangement was made with Bhagwandas and the year of assessment. The case not having been stated in the form of a question, it is necessary for this Court to state that the assessee is not entitled to treat the sum of Rs. 1,600 as a bad debt in the year of assessment.

The Crown is entitled to costs. Hearing fee five gold mohurs.

DHAVLE, J.—I agree. The fact stated by the Income tax Commissioner at more places than one in the paper-book, that in 1930 the assessee in the interests of himself and the other co-creditors took over the assets of the debtor and released the debtor of all further liability, and the circumstance that the assessee did not in subsequent years include the debt in his returns (such as they were) which he made to the Income-tax authorities are in my opinion conclusive against the case that the assessee has endeavoured to make. Stress has been laid on the fact that the income-tax authorities used to estimate a certain amount as interest omitted by the assessee by leaving the personal accounts unadjusted. But it seems to me impossible to contend that this estimate included any specific debt and in particular this debt of Rs. 1,600 which it is claimed only became time-barred in the account in the year 1938 and 1990 Sambat.

Reference answered.

[IN THE ALLAHABAD HIGH COURT].

GANESHLAL BHATTAWALA, *In re.*

COLLISTER and BAJPAI, JJ.

May 5, 1938.

ALLOWANCES—ANIMALS NOT USELESS BUT SOLD BECAUSE BUSINESS IS CLOSED DOWN—LOSS WHETHER ALLOWABLE—BUSINESS EXPENDITURE—EXPENDITURE INCURRED FOR PURCHASING LAND FOR EXCAVATING EARTH FOR MANUFACTURING

BRICK, WHETHER ALLOWABLE—INDIAN INCOME-TAX ACT (XI OF 1922) SEC. 10 (2) (vii-a) and 10 (2) (ix).

Where a dairy business of the assessee was closed down in 1930 and the live stock left over were sold in 1932 at a loss of Rs. 414, and in the assessment of his income from a brick-kiln and property for the year 1933-34 the assessee claimed an allowance in respect of this loss of Rs. 414: Held, that the allowance could not be given inasmuch as the animals were not sold on account of their having become permanently useless but because the business had been closed down, and inasmuch as the words 'for the purposes of the business' in the said clause refer to the business in respect to which a return has been called for and submitted.

Expenditure incurred by the owner of a brick-kiln for the purchase of land for the purpose of extracting earth for manufacturing bricks is not expenditure incurred for earning the profits within Section 10 (2) (ix) but expenditure of a capital nature.

Case referred to :

COMMISSIONER OF INCOME-TAX *v.* TIKA RAM & SONS LTD.
[1937] (5 I.T.R. 544; 1937 A.L.J. 827) *followed*.

Case stated by the Commissioner of Income-tax, U. P. and C. P. under Section 66 (2) of the Indian Income-tax Act, 1922. Mis. Cas. No. 447 of 1934.

STATEMENT OF CASE.

Case stated by the Commissioner of Income-tax, Central and United Provinces, under Section 66 (2) of the Income-tax Act (XI of 1922 hereinafter referred to as the Act) at the instance of Pandit Ganeshi Lal of Saharanpur (a Hindu undivided family within the meaning of Section 3 of the Act hereinafter referred to as the assessee) for favour of decision by the Hon'ble the High Court of Judicature at Allahabad of the questions of law set out in paragraph 3 below arising out of the appellate decision of the Assistant Commissioner of Income-tax, Meerut, in the matter of the assessment of the above assessee for the financial year 1933-34 ended on 31st March, 1934.

2. Facts of the Case.—The assessee works a brick-kiln for profit. For the assessment year 1933-34, the Income-tax Officer, Saharanpur, levied an assessment on the basis of the accounts for the year ending 30th September, 1932, in the amount of Rs. 5,206 including Rs. 175 on account of its income from property. This amount was arrived at after disallowing the following items :

(1) On account of the cost of building house	Rs. 834
(2) do. certain chimneys	„ 506
(3) do. charity	„ 40
(4) On account of the irregular commissions paid	„ 167
(5) do. loss in the dairy account, the assessee having discontinued the business in the year 1930 and the loss being merely the result of the sale of live stock left over	„ 414
Total	1,462

A copy of the assessment order will be found in Appendix A. The assessee filed an appeal as a result of which the Assistant Commissioner allowed items (2) and (4) but not the other items. Item (3) was not seriously contested. As regards item (1), the Assistant Commissioner held that it represented the cost of building materials required for the construction of workmen's quarters and was as such a capital expenditure. As regards item (5) he held that the loss did not pertain to the brick-kiln business and that it arose because the dairy business had been closed down and the animals were no longer required. He, therefore, upheld the action of the Income-tax Officer in disallowing these two items and item (3). Further, he found as a result of his scrutiny of the accounts, that the expenses debited to them included an item of Rs. 2,197 which, though shown as cost of mud for moulding bricks included in fact the price paid for the acquisition of proprietary rights in certain plots of the village in which the brick-kiln was situated and the expenses of the execution and registration of the sale-deed in connexion with it. It was contended by the assessee that the land was purchased for the purpose of extracting earth for the moulding of bricks and the price paid was expenditure necessary for earning the profits assessed but the Assistant Commissioner disallowed it holding that the expenditure was of a capital nature. In the result, he, therefore, enhanced the assessment to Rs. 6,729. A copy of his order is in Appendix B. Against this order of the Assistant Commissioner, the assessee appealed to me under Section 32 (1) of the Act but was unsuccessful. A copy of my appellate order will be found in Appendix C. The assessee has now applied under Section 66 (2) for a reference to the Hon'ble the High Court of the three questions, said to be questions of law, set forth in its application, dated the 25th May, 1934, which is Appendix D.

3. Questions for the decision of the Hon'ble High Court.—The three questions formulated by the assessee (Appendix D) relate to the two items of Rs. 334 and Rs. 414 disallowed by the Income-tax Officer and to the item of Rs. 2,197 added by the Assistant Commissioner. The question whether the item of Rs. 334 represented current repairs to buildings or was the cost of constructing new buildings seems to be purely a question of fact. My finding on the point is that it was not an expenditure on current repairs and this finding being one of fact, no question of law arises out of it. The only questions of law that, in my opinion do arise and which I am accordingly referring for the decision of the Hon'ble Court are :

“In the circumstances of the case,

(1) does the item of Rs. 414 represent such a loss as can, under the provisions of Section 10 (2) (vii) (a) be allowed to the assessee and; (ii) is the assessee entitled to the deduction of the item of Rs. 2,197 out of the profits assessed to income-tax ?

4. Opinion of the Commissioner.—The allowance made by Section 10 (2) (vii) (a) pre-supposes an existing business against the profits of which it is to be made. It does not, in my humble opinion, include a case where the business has ceased to exist for some years prior to the year of account. I, therefore, respectfully submit that for this, as also for the reason given in my order in Appendix C, both the questions should be answered in the negative.

5. As required by rule 7 of the rules framed by the High Court a relevant portion of the statement of the case was sent to the applicant for observations and suggestions, if any. Some additions are proposed by the applicant, but I consider them superfluous for the reasons already stated. A copy of the application from the assessee is annexed for ready reference as Appendix E.”

JUDGMENT.

COLLISTER and BAJPAI, JJ.—This is a reference by the Commissioner of Income-tax, Central and United Provinces, under Section 66 (2) of the Income-tax Act. The assessee was Pandit Ganeshi Lal, now represented by his widow, and he owned and worked a brick kiln. The accounting year is the year ending 30th September, 1932, and the Income-tax Officer assessed him to income-tax at Rs. 5,206. The Income-tax Officer disallowed five items, for which the assessee claimed allowance.

The assessee appealed from the assessment order to the Assistant Commissioner. The latter allowed two of the items in respect

to which allowance was sought. About another item there was no controversy. As regards the other two items, the Assistant Commissioner found against the assessee. One of these items is a sum of Rs. 414 and is described by the Income-tax Officer as "loss in the dairy account, the assessee having discontinued the business in the year 1930 and the loss being merely the result of the sale of live stock left over." The Assistant Commissioner, having scrutinised the accounts, found that the assessee has been debited with an item of Rs. 2,197 which, though shown as cost of earth for moulding bricks, included, in fact, the price paid for the acquisition of proprietary rights in certain plots of the village in which the brick kiln was situated and also the cost of execution and registration of the sale deed. The assessee contended before the Assistant Commissioner that, since the land had been purchased for the purpose of extracting earth for manufacturing bricks, the price paid therefor was expenditure necessary for earning profits; but the Assistant Commissioner repelled this contention and held that the expenditure was of a capital nature. In the result, he enhanced the assessment to Rs. 6,729.

There was a second appeal to the Commissioner under Section 32 (1) of the Act, but the appeal was dismissed. Subsequently the assessee applied to the Commissioner for a reference to the High Court under Section 66 (2) of the Act, and accordingly the Commissioner has referred the following two questions to this Court:—

- (1) Does the item of Rs. 414 represent such a loss as can under the provisions of Section 10 (2) (vii) (a) be allowed to the assessee?
- (2) Is the assessee entitled to the deduction of the item of Rs. 2,197 out of the profits assessed to income-tax?

As regards the first question, Section 10 (2) (vii) (a) provides that an allowance shall be made "in respect of animals which have been used for the purposes of the business otherwise than as stock-in-trade and have died or become permanently useless for such purposes". The dairy was admittedly closed down in 1930, *i.e.*, long before the accounting year; and the Assistant Commissioner finds as a fact that the cattle were not sold because they had become permanently useless but were sold because the dairy business was closed down. Upon this finding it is clear that under the provisions of Section 10 (2) (vii) (a) of the Act no allowance can be given in respect to the cattle thus sold. There is, however, another objection to the claim of the assessee, for it seems clear to us that the words "for the purposes of the business" are

referable to the business in respect to which a return has been called for and submitted. In our opinion the assessee is not entitled to any allowance in respect to this item of Rs. 414.

As regards the second question, the matter has been concluded by a decision of a Full Bench of this Court in *Commissioner of Income-tax v. Tika Ram & Sons, Ltd.* According to that authority the item of Rs. 2,197 is expenditure of a capital nature.

The above is our answer to the reference. A copy of this judgment will be sent under the seal of the Court to the Commissioner of Income-tax. The assessee will pay the costs of this reference. Learned counsel for the Department will certify his fee within six weeks. He is entitled to a fee of Rs. 100.

[IN THE ALLAHABAD HIGH COURT].

JUGAL KISHORE MUKAT LAL, *In re.*

COLLISTER and BAJPAI, JJ.

May 5, 1938.

HINDU UNDIVIDED FAMILY—PARTITION AND FORMATION OF GENUINE FIRM—APPLICATION FOR REGISTRATION AS FIRM—MAINTAINABILITY—MODE OF ASSESSMENT—APPLICABILITY OF SECTIONS 25A AND 26 (2)—INDIAN INCOME-TAX ACT (XI OF 1922) SECTIONS 25A, 26 (2), 26A.

In and until the year 1932-33, the assessee, a father and four sons who carried on business, used to be assessed as a Hindu undivided family. In the assessment year 1933-34 they alleged that there had been a partition between them and that they had formed themselves into a firm, and applied for registration as a firm under Section 26-A. The Commissioner found that there was a partition and the formation of a genuine firm after the close of the account year and before the date of assessment, but upheld the order of the Income-tax Officer refusing to register the assessee as a firm and to make an assessment under Section 26 (2) on the ground that the case was governed by Section 25A and not by Section 26 (2): Held, on a reference by the Commissioner, that the case was governed by Section 26 (2) and not by Section 25A and the assessment must be made on the firm as successor to the undivided family in the manner laid down in Section 26 (2).

Section 25A applies only where there has been a partition among the members of the undivided family and nothing more. Section 26 would apply where a firm has been newly constituted, and it does not matter whether this firm owes its origin to certain

individuals, strangers to each other, entering into a contractual relationship and agreeing to constitute a firm, or whether it owes its origin to a joint family whose members have divided amongst themselves and who have then entered into an agreement to constitute themselves into a firm. In either case, when at the time of making an assessment a firm has come into existence, the assessment must proceed on the basis of Section 26.

The expressions individual, Hindu undivided family, company, firm and other association of individuals used in Section 3 are mutually exclusive.

Cases referred to and followed :—

BELI RAM BROS. *v.* COMMISSIONER OF INCOME-TAX, PUNJAB No. 2 [1935] (3 I.T.R. 243 ; 8 I.T.C. 380 ; 156 I.C. 833).

MITTAROHAND LAKSHMI DAS *v.* COMMISSIONER OF INCOME-TAX, PUNJAB [1937] (5 I.T.R. 127 ; I.L.R. 18 Lah. 189 ; 167 I.C. 936).

RAM RAKHA MAL & SONS *v.* COMMISSIONER OF INCOME TAX, PUNJAB [1937] (5 I.T.R. 137 ; I.L.R. 18 Lah. 325).

Miscellaneous Case No. 48 of 1936.

STATEMENT OF CASE.

Case stated by the Commissioner of Income-tax, Central and United Provinces, under Section 66 (2) of the Indian Income-tax Act XI of 1922 (hereinafter referred to as the Act), at the instance of Messrs. Jugal Kishore Mukat Lal of Khurja, District Bulandshahr, an erstwhile Hindu undivided family (hereinafter referred to as the assessee), for the decision, by the Hon'ble the High Court of Judicature at Allahabad, of the question of law set out in paragraph 3 of this statement, arising out of the appellate order under Section 31 of the Assistant Commissioner of Income-tax, Meerut, in respect of the assessee's assessment for the year 1933-34 (hereinafter referred to as the assessment in dispute) made in the status and manner laid down in Section 25-A (2) of the Act.

2. Facts of the Case.—The assessee carries on grain, speculation and cotton business. In and until the year 1932-33 it used to be assessed in the status of a father and four sons, Hindu undivided family. Its account year is the *Sambat* year ending roughly with the financial year or thereabouts. For the assessment year 1933-34 the assessee submitted a return of its income based on the accounts of the year *Sambat* 1989. This return was not accepted and the Income-tax Officer required it to submit its accounts and evidence by means of notices under Sections 22 (4) and 23 (2) respectively. It was claimed on behalf of the assessee (1) that certain accounts had not been maintained and (2) that certain other

accounts had been lost in a fire that had occurred in its house; further, (3) that there was disruption in the family and (4) that as a result of the disruption alleged to have occurred prior to the account year, a firm under a deed of partnership duly registered had sprung up out of the *quondam* family which, under Section 26 (2), was the successor to its business and, under Section 26A, entitled to registration as a registered firm. The Income-tax Officer found that the disruption took place after the end of the account year, the family having been joint in the account year. As the claim had been made at the time of making the assessment in dispute, the Income-tax Officer held within the purview of Section 25A (1) that there was a partition in the family. As the partition had materialized subsequently to the end of the account year, the Income-tax Officer acted in the manner laid down in Section 25A (2) in making the assessment. He accepted the position that as a result of the partition, the five members of the erstwhile Hindu undivided family had formed themselves into a firm but he refused to register it under Section 26A holding that the imperative provisions of Section 25A (2) required the assessment to be made according to its special provisions. As the assessee had failed to comply in full with the requirements of Section 22 (4) notices, he accordingly made a best judgment assessment within the meaning of Section 23 (4) of the Act, assessing the whole of the joint income jointly in the name of the five partners as required by Section 25A (2). His order under Section 26A dated the 19th December 1934, is copied as Appendix A. The assessee filed an appeal but was unsuccessful. A copy of the Assistant Commissioner's order under Section 31, dated July 8, 1935, will be found in Appendix B. Dissatisfied with the order, the assessee has, *inter alia*, made an application under Section 66 (2) read with Section 33 of the Act. A copy of my order under Section 33, annexed as Appendix C, will show the action I have taken in respect of the remaining three applications of the same kind. A copy of its application under Section 66 (2) in this reference case (No. 18 of 1935-36) will be found in Appendix D. In this application the assessee desires a reference on two questions of law for the decision of the Hon'ble the High Court.

3. Questions.—The first question which relates to the time when the family ceased to be an undivided Hindu family is out and out a question of fact and the other fails to convey the real issue. In the form in which the second question has been posed, it is just as precisely a question of fact as question (1). The questions framed

by the assessee are not, therefore, stateable and I refrain from stating them. The question of law, that embodies the contested issue and which I refer, is: "Whether, when at the time of assessment, a genuine firm had emerged from the disruption of a Hindu undivided family, the joint income of the account year—whether allocable to a part or the whole of that year, had to be assessed in the manner laid down in Section 25A (2); or whether, in view of the succession to the business of the assessee an erstwhile Hindu undivided family by a partnership firm consisting exclusively of the members of the family, the assessment had to be made in the manner laid down in Section 26 (2)".

4. Opinion of the Commissioner.—In my order under Section 33 I have already conceded that on a favourable decision of the above question, that is to say, a decision in its favour, the assessee would be allowed registration under Section 26A. In the converse case, there is no occasion to disturb the assessment, the findings of fact being what they are. A word of explanation is necessary as to the correct import of some clauses of the above question. That a genuine firm had come into existence is not disputed in this case. The assessment for the year 1934-35 has been made on this footing, only a month and five days after (on 24th January, 1935), the assessment in dispute was made (19th December 1934). Indeed the fact that it had come into existence was recognised in the very order of 19th December, 1934, with which the Income Tax Officer decided to make the assessment in dispute under Section 25A. The clause "whether allocable to a part or the whole of that year" has been introduced with a view to take the decision solicited out of the controversy regarding the date on which the partition took effect. That controversy embraces questions of facts which are concluded by the finding of the Assistant Commissioner. His finding is that the partition did not take place in the account year. That is also the finding of the Income Tax Officer. In the manner of the succeeding year's assessment is implicit the recognition of the fact that simultaneously with the disruption of the Hindu undivided family a genuine partnership succeeded to the business of the family. Thus arose inevitably the question dealt with by Section 26 (2) of the Act. The only outstanding difference lies in the question whether in the simultaneous operation of Sections 25A (2) and 26 (2) it is the former or the latter that is to prevail. The Income Tax Officer and the Assistant Commissioner have allowed the former Section 25A (2) to prevail. The assessee claims that Section 26 (2) ought to. The assessee's

contention is based on the Punjab decision in the case of *Messrs Beli Ram and Brothers of Lahore*. This case is one in which all the members of the *quondam* Hindu undivided family continued the business as a partnership concern, without any outside partner. In the Punjab Case only some members of such a family formed a partnership; this brought about a change of identity, so that it could be said that there had been a succession by "another person" within the meaning of Section 26. In this case what happened on disruption was only the continuance of the business of the erstwhile family by all the members of the family on the partnership basis. There was no change of identity and consequently no succession by "another person". The imperative provisions of Section 25A (2) have, therefore, been rightly invoked by the Income Tax Officer. I am, therefore, of the opinion that the first part of the question should be answered in the affirmative and the second part in the negative.

A copy of the relevant portion of the statement of the case was sent to the assessee for observations and suggestions within a fortnight of the receipt of the same. The assessee has not however submitted any suggestions within the prescribed period."

JUDGMENT.

COLLISTER and BAJPAI, JJ.—This is a reference under Section 66 (2) of the Indian Income Tax Act by the learned Commissioner of Income Tax, Central and United Provinces, by which our opinion is sought on one question of law. The statement is dated the 5th January 1936 and the question of law is:—

"Whether, when at the time of assessment, a genuine firm had emerged from the disruption of a Hindu undivided family, the joint income of the account year—whether allocable to a part or the whole of that year—had to be assessed in the manner laid down in Section 25A (2); or whether, in view of the succession to the business of the assessee—an erst-while Hindu undivided family—by a partnership firm consisting exclusively of the members of the family, the assessment had to be made in the manner laid down in Section 26 (2) ".

The facts may be briefly stated. The assessment year in question is 1933-34 and the accounting year is the *Sambat* year 1989 ending roughly with the financial year 1932-33. The assessee Messrs. Jugal Kishore Mukat Lal of Khurja were assessed up to the assessment year 1932-33 as a joint Hindu family. The assessment for the year 1933-34 was made by the Income Tax

Officer on the 19th of December 1934. Prior to this date an application had been made to him that a partition had taken place amongst the members of the undivided family and that a firm had been newly constituted and therefore the Income Tax Officer should proceed to assess under Section 26 of the Indian Income Tax Act and should also register the firm under Section 26A of the Act. The Income Tax Officer held in the course of the assessment order itself that actual separation in the family took place in the beginning of *Sambat* 1980 corresponding roughly to April 1933. He refused to register the firm under Section 26A and made the assessment on the basis of Section 25A (2).

His order was confirmed in appeal by the Assistant Commissioner of Income Tax. On a joint application for review under Section 33 and for a reference to this Court under Section 66 (2) the learned Commissioner of Income Tax refused to give any relief under Section 33, but referred the case to us under Section 66 (2). In his order under Section 33 he observes as follows :

"The real point at issue.....is whether when, at the time of assessment, a genuine firm has emerged from the disruption of a Hindu undivided family, the income of the account year is to be assessed in the manner laid down in Section 25A or whether in view of the succession to the business of the erstwhile Hindu undivided family by a partnership firm, it is to be made in the manner laid down in Section 26 (2). The questions of disruption and succession arose simultaneously in the course of the assessment in dispute and were present before the Income Tax Officer at the time of making it. If it is held that in such circumstances the provisions of Section 25A (2) have been eclipsed by those of Section 26 (2), I have no hesitation in accepting the contention that the emergent firm whose existence has not been disputed should have been registered under Section 26A.... If the assessee is successful and the High Court holds that in the simultaneous application of Sections 25-A and 26 (2) the assessment must be made in the manner laid down in the latter section, that is to say, that it must be made on the footing that a succession had occurred, then the assessee would be entitled and I should be prepared to order an assessment in the status of a registered and not an unregistered firm".

It is thus clear that if we answer the question of law formulated by the Commissioner in favour of the assessee, the Commissioner would be prepared to give him adequate relief by passing formal orders.

As we said before, the Income Tax Officer made the assessment on the 19th of December 1934; the disruption in the family took place sometime in April 1933 and, as pointed out by the Commissioner, the question of disruption and succession arose simultaneously. We must therefore take it that at the time of *making an assessment* a partition had taken place among the members of the family and a firm had been newly constituted.

The question then arises whether under these circumstances the assessment should be made under Section 25A (2) or under Section 26 (2). As we read the above two provisions of law, we are of the opinion that Section 25A applies only where there has been a partition among the members of the undivided family and nothing more. Section 26 would apply where a firm has been newly constituted, and it does not matter whether this firm owes its origin to certain individuals, strangers to each other, entering into a contractual relationship and agreeing to constitute a firm, or whether it owes its origin to a joint family whose members have divided amongst themselves and who have now entered into an agreement to constitute themselves into a firm. In either case, when at the time of making an assessment a firm has come into existence, the assessment must proceed on the basis of Section 26.

It may be mentioned that in the course of the assessment for the year 1934-35 the assessee was assessed as a genuine firm on the 24th January 1935, although the firm had come into existence sometime in April 1933, as found by the learned Commissioner in the present case. The learned Commissioner had before him the authority of a Bench of the Lahore High Court in the case *Beli Ram and Brothers, Lahore v. Commissioner of Income-tax, Punjab N. W. F. and Delhi Provinces*, where it was held, "Where on the breaking of a joint family the separated members immediately form themselves into a firm, Section 26 will come into operation and the assessment on the firm should be made under that section and not under Section 25-A of the Act", but this case was distinguished on the ground that in the *Lahore case* only some members of the quondam Hindu undivided family formed the partnership and this brought about a change of identity so far that it was possible to say that there had been a succession by another person within the meaning of Section 26, but in the case of the present assessee the members of the new firm were the members of the undivided family and thus there was no succession of one person by another person within the meaning of Section 26 (2). We are unable to agree with this view. Section 3 of the Indian

Income Tax Act speaks of an "Individual, Hindu undivided family, company, firm and other association of individuals" and it is clear that all these expressions are mutually exclusive. Under Section 2 clause (9) 'person' includes a Hindu undivided family, but it does not include a firm, and therefore looking into the facts of the present case it can safely be said that a person carrying on a business, profession or vocation (namely, the joint undivided family) has been succeeded in such capacity by another entity (namely, the firm). After the date of the statement by the Commissioner a Full Bench of the Lahore High Court in the case of *Mitterchand Lakhmidas v. Commissioner of Income-tax, Lahore*, has on almost similar facts, held that the assessment ought to be made on the basis of Section 26, and has pointed out that the mere fact that in the previous Lahore case only sum of the members of the joint Hindu family had continued the business on contractual basis while in the case before them all the former members of the family have constituted themselves as a firm on contractual basis makes no difference whatsoever, because the business which was carried on by a joint family is now continued by a firm which has been newly constituted. The matter came up for decision again before the Lahore High Court in *Ram Rakha Mal & Sons Ltd., Amritsar v. Commissioner of Income-tax, Lahore*, and a Bench of that Court reiterated the view held by that Court in the former two cases and observed that Section 25-A of the Indian Income Tax Act "applies only to those cases where the question involved is one of pure and simple disruption of a Hindu undivided family unattended by conversion or transformation into a new entity" and that sub-sections (2) and (3) of Section 25-A "are merely complementary of the first sub-section and deal with only those matters which arise therefrom" and similarly Section 26 "is intended to meet completely those cases which are specified in sub-sections (1) and (2) thereof respectively, *in whatever way the situation envisaged there may arise*".

We are in complete agreement with the view entertained by the Lahore High Court, and our answer to the question referred to us is that the assessment in the present case ought not to be made in the manner laid down in Section 26 (2) of the Indian Income-tax Act. Let a copy of this judgment be sent to the learned Commissioner of Income-tax under the seal of the Court and the signature of the Registrar. The department must pay the costs of this reference. We fix the fee of the counsel for the department at Rs. 100. He will file the certificate within six weeks.

[IN THE RANGOON HIGH COURT].

COMMISSIONER OF INCOME TAX, BURMA

v.

KOKINE DAIRY, RANGOON [No. 2].

SIR E. G. ROBERTS, C.J., DUNKLEY and SPARGO, JJ.

April 27, 1938.

AGRICULTURAL INCOME—DAIRY FARM—WHETHER INCOME IS AGRICULTURAL IS A QUESTION OF DEGREE AND OF FACT—DIFFERENCE BETWEEN INCOME FROM STALL-FED CATTLE AND CATTLE PASTURED ON LAND—DUTY OF INCOME-TAX OFFICER—REFERENCE—APPLICATION FOR MANDAMUS—PRACTICE—APPEARANCE OF COMMISSIONER'S COUNSEL—INCOME-TAX ACT (XI OF 1922), SECS. 2 (1), 4 (viii), 66 (3).

For the purpose of considering whether income from a dairy farm and the milk derived from the farm is agricultural income and exempt as such from income tax it is necessary to inquire whether the cattle are kept in an urban area and stall-fed or whether they are pastured upon the land. If they are kept in an urban area and stall-fed, then the business of keeping them could scarcely be considered agricultural, and must be considered as trade. The question is a question of degree and therefore a question of fact.

ROBERTS, C. J.—*Where cattle are wholly stall-fed and not pastured upon land at all the income would doubtless be income from trade; where cattle are being exclusively or mainly pastured and are none-the-less fed with small amounts of oil cake or the like, it may well be that the income derived from the sale of their milk is agricultural income. But between the two extremes there must be a number of varying degrees and the task of the Income-tax Officer is to apply his mind to the two distinctions and to decide in any particular case on which side of the line the matter before him fallsHe has to see whether the cattle derived sustenance to a material extent from the produce of the ground; and whether they did so or not is entirely a question of fact for him and one which cannot be reviewed by the High Court.*

In applications under-Section 66 (3) of the Income tax Act it would be wrong to require the appearance of the counsel for the Commissioner in the first instance, as most of such applications do not raise any question of law and may be dismissed in limine. If after hearing the applicant the Court desires to hear the Commissioner's counsel the case can be adjourned for hearing the latter.

Kokine Dairy Farm, In re No. 1. [1938 *I. T. R.* 145] dissented from.

Case referred to :

LEAN AND DICKINSON *v.* BALL [1925] (10 Tax Cas. 341 ; 1926 Sess. Cas. 15 ; 1925 Sc. L. T. 617).

Civil Ref. No. 1 of 1938.

Case stated under Section 66 (3) of the Income-tax Act of a question arising from the Appellate Order on the assessment for 1936-37 upon the unregistered firm trading as "The Kokine Dairy". The order of the High Court requiring the Commissioner to state the case is reported at 1938 *I.T.R.* p. 145. *q. v.*

STATEMENT OF CASE.

"Statement is required by orders of your Lordships in Civil Miscellaneous Application No. 75 of 1937, upon the question :—

"Whether the income derived from the business was agricultural income or not".

Statement of facts.—2. The assessed business is of long standing, but it was only in April 1936 that the Income-tax Officer first had grounds for opining that the proprietors were liable to income tax. He accordingly then issued notice under Section 22 (2) of the Act, for return for 1936-37 assessment.

Return was filed, showing Nil income, together with a note : "The income of the Kokine Dairy Farm being entirely agricultural, is not assessable to income-tax".

Before proceeding under Section 23, the Income-tax Officer summoned the "manager" for evidence under Section 37. After recording his evidence he gave an adjournment for "an opportunity to prepare a statement regarding actual income". Some accounts were then tendered, but they did not relate to this assessment's "previous year". (The "accounts" as tendered ran only from December 1935 up to August 1936 and were only described as "Rough Statement of Income and Expenditure". In this period they showed approximately Rs. 9,900 receipts ; and against this a total of about Rs. 12,000 mostly estimated expenses, comprising Rs. 5,300 for cattle food, Rs. 5,200 for wages, and Rs. 81-11 land revenue for land at Kokine Rs. 825 at Mogyobyit. It may be noted here that the evidence shows that milk production is almost wholly at Kokine. The Mogyobyit land is used only in part in connection with this business,

3. Thereupon the requisite notice under Section 23 (2) was served; and the only evidence tendered was a further statement of the manager himself.

A full copy of all the evidence, (both under Section 37 and Section 23), is annexed "A".

4. The Income tax Officer proceeded to pass his assessment order annexed "B". The tax demanded is Rs. 13-5.

Appeal was laid on the ground:—

"Your petitioner claimed in the return aforesaid that the Kokine Dairy should not be assessed to income tax as its income was entirely agricultural within the meaning of Section 2 of the Act and in his statement to the Income-tax Officer he also alleged that during the year 1935 the Dairy had suffered a loss of more than Rs. 3,000. Petitioner also submitted a statement showing the gross sales of milk for nine months commencing the last day of December 1935 as some indication of the income of the Dairy. The Income tax Officer, however, was pleased to ignore the point of law raised by petitioner and assessed petitioner on an entirely erroneous basis".

The appellate order is annexed "C".

5. Application was made under Section 66 (2) setting out:—

"Your petitioner submits that the heard of cattle are kept on land paying land revenue and that the cattle derive sustenance to a very large extent from the produce of the land and that the rearing of cattle and selling of milk without performance of any process thereon are entirely agricultural operations and that as such the whole income of the Dairy Farm is totally exempt from taxation".

The application for reference was rejected by my order, annexed "D", the gist of it being:—

"It is clear that the mere standing of cattle upon land of this type does not make the milk derive from that land. There is and can be no contest about that; and the sole issue is whether in fact the milk production is from this land, or mainly from purchased fodder. The case becomes then almost identical with *Stephenson v. Waller* (18 T.C. 323)".

I may add that the mandamus application to your Lordships elaborated the assessee's case no further.

Opinion of the Commissioner.—6. The assessee does not contend before your Lordships that he had not the assessed income and the estimate of its quantum is not in issue.

What is claimed before your Lordships is the benefit of an exemption. It is well settled that the onus of proving facts putting him within any claimed exemption lies wholly upon him. He did not even seek to supplement his evidence on this matter before me under Section 33; and of course your Lordships' seizin must in any event be confined to the evidence that was put before the appellate authority whose order thereupon is under question.

7. The exemption claimed is that under Section 4 (3) (viii) with 2 (1) (b), applicable to "income derived (a) by agriculture, (b) from land which is used for agricultural purposes and is assessed to land revenue". (The further details under the clause cited do not seem to be material).

8. The comparable United Kingdom provision turns on what *Konstam* at page 95 of his 1923 edition describes as somewhat obscure specialities of drafting. The essential point however there is whether lands are "occupied solely or mainly for husbandry"; and (vide page 98, *loc. cit.*) :—

"Where lands are occupied by a seller of milk, and the lands are found by the Commissioner to be insufficient for the keep of the cattle brought on to them, they may charge the occupier under schedule D. If strictly applied, this rule would allow an assessment under Schedule D in any dairy or grazing farm where the cattle are fed on cake or other purchased article; but it is not so applied in practice, perhaps because the farmer is not necessarily a dealer". The rule at any rate prevent a milk seller who feeds his cattle on accommodation land from claiming (Exemption)".

The cases decided since that was written, notably *Lean and Dickson v. Ball* (10 T. C. 341), *Jones v. Nuttal* (10 T. C. 346) and *Stephenson v. Waller* (13 T. C. 323) referred to above, and more particularly 19 T.C. 607, bring out more strongly that it is a question of the degree to which the produce sold can be directly attributed to the land and the user of the land. The last case particularly points out that this is an issue of fact. (The latest case is, I think, *Long v. Belfield Poultry Products*, 81 S. J. 588, decided last June; but it takes the position no further).

9. The present issue of course has to be referred to the different speciality of our own Act. But the question is essentially the same, *viz.*, the extent to which this milk was produce of the revenue-paying land—accepting that the milk of cattle wholly or mainly pastured is produce of that pasture land, and that pasturing is agriculture, but stall-feeding is not.

It might possibly have been open to the assessee to contend that at any rate some part of his *whole* profits did derive from the land and there should be an estimated partial exclusion accordingly. No such point was however taken by him—possibly because the pasturage contribution is obviously extremely small, possibly because the assessable income is in any event only an estimate. What he actually claims is simply that the whole of his business is “agricultural”: that is, that all the milk he sold was in fact the “produce” (crop) of his revenue-paying land, principally the 20 odd (for details see Annexure A) acres occupied for dairy purposes at Kokine. The question on which your Lordships can take seizin appears to be only whether the evidence he put before the Assistant Commissioner left it impossible for that officer to hold that this fact was unestablished.

The adverse finding rests mainly on the following points:—

(a) The food bill (though not tendered for the properly relevant period) was sufficient indication in its admission that over half the gross receipts went on purchased food:

(b) The revenue paying acreage used for the milch cattle was enormously less than the area necessary for full pasturing (which is from 3 to 15 acres per head).

In my opinion, not only did the assessee entirely fail to discharge the onus upon him; there was even positive material on which the Assistant Commissioner could base his adverse finding.

10. I beg leave to refer to the concluding paragraph of the mandamus order, since it may affect your Lordships’ award of costs. The paragraph referred to is—

“I only desire to add that I think it is extremely unfortunate that the Commissioner of Income-tax has not seen fit to come before this Court by instructing the Advocate-General, who is always only too willing to give every assistance possible to this Court whenever he is instructed. Cases are seldom as simple and clear as is often imagined”.

11. In the first place, I wish to make it clear that it is never my wish to stand (otherwise than formally, and in your Lordships’ own interests) as opposing any mandamus application.

In the United Kingdom, orders are actually passed by the Court: there is the general injunction against “stating out of Court”: and reference applications are practically never refused.

In this country, the passing of final orders lies always with the Commissioner. Moreover, even if the assessee succeeds on a point of law on the evidence laid before the Court, the

Commissioner may re-open the case (Vide Privy Council Judgment in Bombay Trust Corporation). The Commissioner is the final authority on fact; and he is further entitled to the authoritative guidance of your Lordships on Law—whether on his own instance, or that of the assessee. The Commissioner and the Court are both under duty, towards seeing that the subject is rightly assessed, the same duty though on specified and different parts of the whole.

The only express provision in the Act enabling the Commissioner to dispose of a contention in law is the obviously convenient one for avoiding proceedings where he himself agrees with the assessee. This does practically mean that in every *stated* case, the opinion he is required by the Act to give—presumably for your Lordships' assistance—will be adverse: and that at this stage he must appear as "opposite party". But it seems to me to be undesirable in the light of his responsibilities as above, that the Commissioner should even seem to be any less detached than the Court itself, and to resist the examination of any case by the Court on point of law duly raised. And there is no matter that cannot be questioned in *form* of law—though whether the contention as actually raised really is of law is a different matter.

12. Now in India, some provinces have no less than three hundred times the number of applications for reference, in proportion to revenue, as in the United Kingdom: amounting to enough to occupy a Bench fully throughout the judicial year; and in Burma the position is only somewhat less extreme in degree. A very large proportion is obviously not truly on contest in law. The Case Law, up to the Privy Council (*Laxminarain Badridas*, 19th February 1937—"The questions involved were purely of fact, and no reference should have been made") has established that such cases should not be referred: and accordingly over 90 per cent. never come up to trouble the Court at all.

Where such a case is referred, the Commissioner invariably sets out his reasons for concluding that it is not referable.

The Court may then on application under clause (3) decide that the contention duly raised is truly (and not merely in form) one properly requiring the expenditure of the time of a Bench upon it. It is for your Lordships there to decide whether it is a waste of the Bench's time or not: and as above I think it undesirable to seem to want to intervene in that regard.

In another jurisdiction, I pointed this out and proposed never to enter appearance in that stage, though expressing my willingness

to give all *further* assistance desired by the Court (towards avoiding such waste of a Bench's time, etc.) by instructing on request an Advocate for any further elucidation of the refusal order that might be desired—this even in a jurisdiction where the Commissioner was so over-worked that any addition to his Reference work was a considerable burden, and where the Court's decisions were generally not very highly esteemed by the Department: neither of which factors would stand against the adoption of such a practice here.

13. In this jurisdiction I have generally followed the previous practice of instructing the Advocate-General to appear. In this particular instance however, the case is very petty. I should actually welcome a decision in law which will enable me to deal further with the case and have the profits re-estimated on a reopening on the lines of Bombay Trust: (though having regard to my position of final responsibility on such matters, I did not wish to take proceedings for enhancing the estimation myself). The refusal order set out the case and was short and simple; and the considerations did not seem capable of further elucidation at least towards showing whether the contest was truly in law or not. Accordingly I entered a formal written objection in terms "That the application may be dismissed for reasons contained in my order under Section 66 (3). The case appears to be so simple and clear that I shall not instruct the Advocate-General to appear *unless so desired by the Court for the assistance.*

No intimation was given to me of the desire of the Court for such assistance. I request that costs may wholly and normally follow the eventual decision."

Kalyanwala, for the Assessee.

U Thein Maung (Advocate-General), for the Commissioner.

JUDGMENT.

ROBERTS, C. J.—In this application the Kokine Dairy, wrongly called the respondents, applied for and were granted a mandamus by a Bench of this Court and are in the position of applicants in this case, a reference having been made to us under Section 66 (3) of the Income Tax Act submitting the following question which is denominated as a question of law:—

"Whether in the circumstances of the petitioner's case the income from the Kokine Dairy is not agricultural income within the meaning of Section 2 (1) of the Act and as such exempt from taxation under Section 4 (3) (viii) of the Act?"

The question submitted is in my opinion as framed a pure question of fact: the question of law is whether there was material upon which the Income-tax Officer could find that the income from the Kokine Dairy was not agricultural income. What is exempted from tax by the Income tax Act is agricultural income and for the purpose of considering the position of a dairy farm and the milk which is derived from it, it is necessary to enquire whether the cattle are kept in an urban area and stall-fed or whether they are pastured upon the land. If they are kept in an urban area and stall-fed, then the business of keeping them could, in my opinion, and in agreement with the opinion expressed in "*Sundaram's Law of Income-tax in India*," Edn. 4, p. 77) scarcely be considered agricultural and must be considered as trade. It is said that in an urban area and stall-fed, the land would not be assessed: but if the dairy-farming business is assessed to income-tax, the land revenue paid will, of course, be one of the expenses of the business. In my opinion, the question must be a question of degree and therefore a question of fact. Where cattle are wholly stall-fed and not pastured upon the land at all, doubtless it is trade and no agricultural operation is being carried on: where cattle are being exclusively or mainly pastured and are none the less fed with small amounts of oil-cake or the like, it may well be that the income derived from the sale of their milk is agricultural income. But between the two extremes there must be a number of varying degrees, and the task for the Income-tax Officer is to apply his mind to the two distinctions and to decide in any particular case on which side of the fence, if I may use the term, the matter falls.

In the case cited before us, *Lean v. Ball*, LORD CULLEN said that he proceeded on the footing that the case, which was one dealing with poultry-farming, was one in which the poultry derived sustenance to a material extent from the produce of the ground. Applying that principle to this case, in my opinion, the Income Tax Officer has to see whether the cattle derived sustenance to a material extent from the produce of the ground and whether they did so or not is entirely a question of fact for him and one which cannot be reviewed by this Court. It is not necessary for us to say whether we agree with the decision at which he arrived or not. It is sufficient to remark that he had before him one piece of material certainly, namely, the evidence of the disbursement by the assessee of substantial sums of money upon oil-cake which led him to the conclusion to which he arrived. It follows that the

application must fail with costs against the Kokine Dairy, ten gold mohurs.

I desire to add that, whilst, reluctant to disagree with one of the learned Judges who made the reference, I do not accept the view put forward by my learned brother Sharpe that the Advocate-General should always attend in these cases, and it appears to me that the Commissioner of Income tax has set out the situation with fairness in the statement which he has made in this behalf.

DUNKLEY, J.—I agree. As regards the appearance of the learned Advocate-General in applications under Section 66 (3) of the Income Tax Act to this Court for a mandamus, in my own view it would be wrong to require his appearance in the first instance, because most of these applications plainly do not raise any questions of law and they can be dismissed in limine without hearing the learned Advocate-General on behalf of the Commissioner of Income tax. If, after hearing the applicant, the Bench considers that the case for the Commissioner of Income tax should be placed before them at that stage, then it is simple to adjourn the case in order to obtain the appearance of the learned Advocate-General for the Commissioner of Income tax. That is the practice which in my opinion, should be adopted in such applications.

SPARGO, J.—I agree with the order passed by my Lord, the Chief Justice, and I have nothing further to add.

Application dismissed.

[IN THE ALLAHABAD HIGH COURT.]

LALA TRIBENI RAM, *In re.*

COLLISTER and BAJPAI, JJ.

May 6, 1938.

FIRM—DEED OF DISSOLUTION OF PARTNERSHIP—FINDING THAT DEED WAS A FABRICATION GOT UP TO DEFEAT REVENUE—FINDING OF FACT—EVIDENCE.

Assessee received notice under Sec. 34 in respect of the years 1931-32 and 1932-33, and he had to appear before the income tax authorities on the 28th April, 1933. On that day he produced a deed of dissolution of partnership dated 26th April 1933 which recited that a dissolution had taken place some time in October 1932. The deed contained contradictory and false recitals and the income tax authorities came to the conclusion that the deed was a fabrication

got up to enable the assessee to have his personal loss set off against the profits of the partnership: Held, on a reference by the Commissioner that there was evidence to support the finding of the income tax authorities and the finding, being one of fact, was conclusive.

Miscellaneous Case No. 344 of 1935.

STATEMENT OF CASE.

Case stated by the Commissioner of Income tax, Central and United Provinces, under Section 66 (2) of the Indian Income Tax Act XI of 1922 (hereinafter referred to as the Act) at the instance of Lala Tribeni Ram of Bridgemanganj, head and representative of a Hindu undivided family (hereinafter referred to as the applicant) for the decision by the Hon'ble the High Court of Judicature at Allahabad, of questions of law, set out in paragraph 3 of this statement, arising out of the appellate order under Section 31 of the Act, of the Assistant Commissioner of Income tax, Benares, in respect of the assessments to income tax of the firm of Messrs. Tribeniram Ramsahai of Village Nautanwa, District Gorakhpur (hereinafter referred to as the assessee firm) for the years 1931-32 and 1932-33. A copy of the application under Section 66 (2) is annexed as Appendix A.

Facts of the Case.—2. The applicant carried on grain and ghee business and worked a brick kiln for profit. Up to and for the year 1930-31 all his business was assessed as the joint family business. In the year 1931-32 the Income tax Officer, Gorakhpur assessed him under Section 23 (4) but on appeal against the Income tax Officer's adverse order under Section 27 this assessment was cancelled and a fresh one was directed to be made. The appeal was decided on the 24th November 1932. Meanwhile proceedings were going on for the assessment of the applicant for the year 1932-33 commencing from the 1st April 1932. The Income tax Officer happened also to be dealing in the interval with the assessment of one Balram Das in the course of which it came to his notice that he was a partner with the applicant of a seven-anna share in a cigarette business at Nautanwa in the Gorakhpur District. The applicant informed him that Balram Das shared only in the profits of the business by way of remuneration for his service as a working partner and that he was not a partner in the strict sense of the word. The Income tax Officer, therefore, closed the proceedings which he had started for the assessment of Balram Das on the partnership basis. This happened in August 1932. Subsequently when the Income tax Officer was engaged

in the examination of the applicants' accounts for the grain business at Nautanwa carried on under the name and style of Tribeniram Ramsahai it transpired (1) that one Ramdas was a partner of a seven-anna share in it and (2) that this partnership in its corporate capacity held a nine-anna share in the cigarette business, the remaining seven-annas in which were allotted to Balram Das as stated above. These facts were affirmed by the applicant and are common ground in this case. A copy of his statement dated the 30th March, 1933, in English and transliteration in vernacular will be found in Appendix B. The Income Tax Officer therefore accorded a separate treatment to the grain business which had hitherto been treated as a part of the applicant's business and treated it as a partnership business. As the applicant had himself treated Balram Das not to be a partner in the proper sense of the word it followed that the cigarette business was a branch of the grain business. Both were carried on at Nautanwa and the Income tax Officer started on this accepted footing to assess the two businesses as a single partnership concern, namely, as an unregistered firm. To this end he served on the assessee firm notices under Section 22 (2) and that read with Section 34 in respect of the years 1932-33 and 1931-32 respectively. The immediate response to these notices was an application dated the 27th April, 1933, in which the applicant purported to bring it to the notice of the Income tax Officer that owing to differences among partners it was decided to dissolve the partnership with Ram Das, that the grain business had closed down on *Katik Badi* 15, 1989 (corresponding to the end of October or beginning of November 1932) and that he had succeeded to the cigarette business as the sole proprietor. In the end the applicant sought in feigned naivete, the Income tax Officer's advice how he was to proceed in view of the consequent operation of Section 26. This application is remarkable as the foundation of the applicant's subsequent defence in this case and a copy of it is, therefore, annexed as Appendix C. Behind it was concealed the fact that the applicant had large losses in his personal business. The Income tax Officer advised him to file the returns as required and then to point out the fact at the time of the assessment. On the 28th April 1933, the applicant, when attending the Income tax Office for the prosecution of his personal assessment, submitted the returns in respect of both the years in issue but with a protest. At the same time he filed a registered deed of the dissolution of partnership between himself and Ram Das bearing date the 26th April 1933. The dates

are of importance. Further the applicant requested that as he had produced all the evidence in respect of both the returns the hearing under Section 23 (2) might be allowed on the same date and the assessments disposed of. The Income Tax Officers accordingly served on him notices under Section 23 (2) then and there and reduced his statement to writing. Having already had certain enquires made through the Inspector of Income Tax and as there were certain features in the deed which appeared to him suspicious the Income tax Officer did not dispose of the assessment forthwith but directed the applicant, by means of a written order served on him at the same time, to prove the genuineness of the deed by producing on the 11th May 1933, the two persons Balram Das and Ram Das who purported to have withdrawn themselves from the partnership. Balram Das did not attend but Ram Das did. His statement was taken down. His deposition that he shared both in the profits and losses of the grain business was in conflict with the recital in the deed that he shared in profits only. He was one of the parties to the execution of the deed. A translation and transliteration of the deed will be found in Appendix D. After taking down the statement of Ram Das the Income tax Officer adjourned the case to the next day, namely, the 2nd May, 1933, so that Balaram Das might be able to attend. This turned out not to be possible but as the applicant had himself declared on the 30th March 1933, that Balaram Das did not share in losses in the cigarette business, and the Income tax Officer had accepted the position in August 1932, the only other point to which he was required to testify, namely, that he had satisfied himself before signing the deed of dissolution was not very material since he was not concerned with the grain and would therefore view the transaction exclusively from his interest in the cigarette business. The Income tax Officer, therefore, considered it unnecessary further to adjourn the case with that object. The applicant put in two successive applications on this date (1) requesting that suitable time might be allowed him to have certain mistakes appearing in the deed of dissolution rectified and (2) that the scribe who drew up the indenture might be summoned as a witness. The Income tax Officer refused to grant these requests and resumed the hearing of the case on the following day, that is, the 3rd May 1933. On this date the assessee purporting to act under Section 31 of the Specific Relief Act, filed a registered deed bearing date the 3rd May 1933, signed by all the three executants of the original deed of dissolution (Appendix D) by means of which *inter alia* the clause relating

to Ram Das being a sharer in profits only was amended to being a sharer in both profits and losses. Holding that the deed of amendment (Appendix E) was *prima facie ultra vires*, and for the five reasons stated in the assessment order namely (1) for the ambiguity of expression in paragraph 2, (2) for the inconsistency of the recital with the consequence of the dissolution, (3) for the conflict between the deliberate statement in the last sentence of the statement with the more reliable entries in the accounts, (4) for the incoherency of the deed and, last of all, (5) for the absence of any reference to the dissolution of the partnership in the applicant's statement of 30th March 1933 (Appendix B) the Income tax Officer held the deed to be a fabrication for the purposes of evading income tax and declined to give effect to it. He accordingly on the 3rd May 1933 assessed the assessee firm in the amount of Rs. 6,847 for the assessment year 1932-33 and in the amount of Rs. 1,577 for the year 1931-32 as its total income. A copy of his assessment order will be found in Appendix F. The applicant did not challenge the amount of the income assessed but challenged, in view of Section 26 of the Act, the maintenance of assessment as that of the assessee firm, whereas he claimed that the income should have been assessed on himself as the sole proprietor of the business. He accordingly appealed contending (1) that the facts contained in the Inspector's diary could not be admitted in evidence under Section 60 of the Evidence Act without proper proof of it (the diary); (2) that the unrebutted oral and documentary evidence had established that there was a succession to the partnership within the meaning of Section 26 of the Act; (3) that the deed of the 3rd May 1933, could not be discarded in view of Section 31 of the Specific Relief Act; (4) that the question put to the applicant relating to the period covered by the account book, and his answer as contained in his statement dated the 30th March 1933, (Appendix B) pertained only to that period, (5) that the rejection of the dissolution was meaningless as the dissolution had materialized and was not subject to the approval of the Income tax authorities. The Assistant Commissioner dismissed the appeal (Appendix G) holding that no dissolution had taken place and that the deed of the 26th April 1933, (Appendix D) was executed merely with the object of supporting a false plea in order to secure an advantage in income tax proceedings because (1) it did not contain the essential statement of facts which a genuine document of this kind ought to contain, (2) the fact of dissolution would have been referred to in the applicant's statement of 30th March

1933, had it been an accomplished fact and, (3) the accounts showed that transactions continued on the partnership basis as between the applicant and the partners despite the so-called dissolution.

Question for the decision of the Hon'ble the High Court.—3. Out of these facts the applicant has evolved 7 questions described in his application under Section 66 (2) (Appendix A) for reference.

As the cumulating effect of the various propositions disjunctively stated in formulating the questions the only question of law that emerges and is conclusive of this case to my mind is :

“ In the circumstances of this case, was there no admissible evidence for the Income tax authorities to consider the deed of dissolution (Appendix D) as a fabrication for Income tax purposes? ” Your Lordships are not concerned with the existence of that amount of evidence on the point which must lead to an answer either way inevitable. It is enough if your Lordships decided whether or not the conclusions of the authorities were founded on any admissible evidence. I am unable to discover the relevancy of the Specific Relief and the Contract Acts invoked by the assessee and there is no dispute that if a genuine succession has happened Section 26 of the Act was applicable. The finding of the Assistant Commissioner is that that is not the case. I accordingly refer the only question above as the decision of Your Lordships if favourable to him, will enable me to give the assessee complete relief in respect of both the years in dispute. The facts are the same for them and the questions that the assessee has suggested are also identical. I have, therefore, made out a single statement in respect of both the years for which I crave your Lordships' indulgence.

Opinion of the Commissioner.—I am unable, on a perusal of the entire evidence in this case, to differ with the Assistant Commissioner in the conclusions at which he has arrived after weighing the entire evidence on the record. My submission respectfully is that the deed of dissolution executed with retrospective effect on the eve of the day on which the return was required had no meaning other than what the Income-tax Officer and the Assistant Commissioner have given it unanimously. To my mind they have correctly drawn their references from the applicant's statement (Appendix B) of the 30th March 1933, and I, therefore, submit that the question should be answered in the sense that there was admissible evidence.

5. An extract copy of the relevant portion of the statement was sent to the applicant for observation and suggestions and a

copy of his letter is annexed as (Appendix H.) After perusing it I am unable to discover any reason to modify the statement of the case above or to include therein the exact translations of the entries in the account books which form an enclosure to the letter.

JUDGMENT.

COLLISTER and BAJPAI, JJ.—This is a reference under Section 66 (2) of the Indian Income Tax Act from the learned Commissioner of Income-tax, Central and United Provinces. The assessee in the present case is Lala Tribeni Ram of Bridge-manganj, and the assessment years are 1931-32 and 1932-33. The question of law that has been referred to us for our opinion is as follows:—

“In the circumstances of this case was there no admissible evidence for the income-tax authorities to consider the deed of dissolution, dated the 26th of April 1933, as a fabrication for income tax purposes?”

It is not denied that the assessee was at one time a partner in his business with Balram Das and Ramdas and the assessment for the two years in question has been made on the basis of this partnership. The assessee's case, however, was that there had been a dissolution between the partners some time in October 1932 as evidenced by the document dated the 26th of April, 1933. This document was produced before the Income-tax Officer on the 28th of April 1933. The reason why the assessee alleged a dissolution of partnership was that he wanted his personal loss to be set off against the profits of the partnership. The Income tax Officer was of the opinion that there was no dissolution of partnership in fact and the document, dated the 26th of April 1933, was brought into existence for the purposes of the assessment and was never intended to be acted upon. The learned Assistant Commissioner of Income-tax agreed with the view of the Income-tax Officer. The Commissioner refused to give any relief under Section 33 of the Indian Income Tax Act but has referred the question of law mentioned before under Section 66 (2) of the Act for our opinion.

There can be no doubt that the question of law should arise out of the appellate order of the Assistant Commissioner under Section 66 (2) of the Act and the findings of fact arrived at by the Assistant Commissioner cannot be challenged, and thus the only question that has been referred to us is whether there was no admissible evidence for the finding that the deed of dissolution

was a fabrication for income tax purposes. The Assistant Commissioner went into the matter very carefully. He emphasised the fact that although the dissolution was said to have taken place some time in October 1932, no document was drawn up till the 26th of April 1933 and that the document was produced on the 28th of April 1933 when the assessee appeared in response to a notice under Section 23 (2) and when the assessment order was about to be passed by the Income Tax Officer. He then looked into the deed and saw that it contained a number of contradictory and false statements. He scrutinised the account books and they showed that even after the alleged date of dissolution the various partners were receiving profits from the business. He agreed with the Income-tax Officer that no dissolution had taken place and that the document dated the 26th of April 1933 was executed merely with the object of supporting the false plea of dissolution of partnership in income tax proceedings but was never intended to be acted upon and that the light of attending circumstances and the independent evidence of account books demonstrated that the view of the Income-tax Officer was correct. The evidence on which the Income-tax authorities relied was the inaccurate and contradictory statements contained in the document itself and the account books. Under these circumstances it is not possible to say that there was no admissible evidence for arriving at the finding that the deed of dissolution was a fabrication for income-tax purposes. Our answer to the question referred to us is that there was admissible evidence for the Income tax authorities to consider the deed of dissolution as a fabrication for income-tax purposes. Let a copy of our judgment be sent to be Commissioner of Income-tax under the seal of the Court and the signature of the Registrar. The assessee must pay the costs of this reference. Counsel for the Department is entitled to a fee of Rs. 100. He will file his certificate within six weeks.

Reference answered accordingly.

[IN THE RANGOON HIGH COURT.]

N. A. CONCERN

v.

COMMISSIONER OF INCOME TAX, BURMA.

SIR E. G. ROBERTS, C. J., and DUNKLEY, J.

February 7, 1938.

BEST JUDGMENT ASSESSMENT—PROCEEDINGS FOR CANCELLATION—REFERENCE—SCOPE OF ENQUIRY—QUESTIONS THAT CAN BE CONSIDERED—INCOME-TAX PROCEEDINGS—*Res Judicata*—OPINION EXPRESSED BY PREVIOUS OFFICER—HOW FAR BINDING IN FRESH PROCEEDINGS—INCOME-TAX ACT (XI of 1922), SECTIONS 28 (4), 66 (2).

The Income-tax Officer in an order made under Sec. 27 of the Income-tax Act said that he could accept the possibility of the non-maintenance of accounts at headquarters, but that he was not prepared to accept the explanation given in regard to certain other accounts. The Commissioner while ordering in revision that fresh proceedings should be taken under Sec. 22 (4) for the production of the assessee's account books and that the previous proceedings under Sec. 23 should be cancelled said that the Income-tax Officer had abandoned the principal default, namely, the failure to keep headquarters accounts. In the fresh proceedings the assessee contended that it was not open to the department to go behind the opinion previously expressed that he did not keep headquarters accounts and asked for a mandamus under Sec. 66 (3) directing the Commissioner to refer this question to the High Court; Held that there was no foundation for the suggestion that because an earlier Income-tax Officer was disposed to fasten on the particular default and said that he might possibly accept the explanation given in regard to others, it meant that when a re-commencement of the whole proceeding has been directed the subsequent revenue officers are to blind themselves to the obvious facts when the case is taken up again:

Held also, that in a case under Sec. 27 of the Indian Income-tax Act for cancelling a best judgment assessment the only question of law that could arise for reference is whether there was evidence upon which the Assistant Commissioner could have based his order; the question whether the assessment as made was valid is not

a question of law that could arise out of the order of the Assistant Commissioner.

A.K.R.P.L.A. Chettiyar Firm v. Commissioner of Income-tax, Burma [1931] (I.L.R. 9 Rang. 25; 1931 A.I.R. Rang. 98; 132 I.C. 718), followed.

Civil Misc. Application No. 90 of 1937.

P. K. Basu, for the Assessee.

U Thein Maung (Advocate-General), for the Commissioner.

JUDGMENT.

ROBERTS, C. J.—This is an application for a mandamus made under Sec. 66 (3) of the Income-tax Act, 1922, requiring the Commissioner to state a case on the following question:—

“Could the Income-tax authorities go behind the findings of the Income-tax Officer dated 6th April 1935 in which he accepted the submission of the applicant that he did not keep any accounts at the headquarters and which was not set aside either by the Assistant Commissioner in appeal or by the Commissioner in revision, and could that finding be over-ridden by his successor in office?”

The question was raised before us on two grounds, the first being that there were no materials upon which the Income-tax Officer who has made the present assessment could find that headquarters books of account were actually in existence, or that the money withdrawn by the assessee had been reinvested. I think there were ample materials upon which the Income-tax Officer could so find, and he has set them out very succinctly in his order, and the question whether we should have come to the same conclusion is not one which need be considered; speaking for myself, if I had the same facts before me, I feel that I should not have had any doubt in coming to the conclusion arrived at by the Income-tax Officer. The second point which has been raised is that the Commissioner in his order dated 30th October 1935 directed that fresh proceedings should be taken under Sec. 22 sub-section (4) and that steps to produce the books should be taken and that the previous proceedings under Sec. 23 of the Act should be cancelled and it is suggested that because the Commissioner said that the Income-tax Officer had abandoned the principal default, namely, the failure to keep headquarters accounts this matter should not be re-opened again. I am of opinion that the Commissioner merely meant that the whole of the circumstances were to

be re-examined. The Income-tax Officer in his order of April 1935, said :

“ I can accept the possibility of the non-maintenance of accounts at headquarters ; but I am not prepared to accept the explanation given in regard to the two *vatti chitais* in question.”

And the Commissioner, in referring to this matter, said that since in his order under Sec. 27 the Income tax Officer abandoned the principal default, the issue narrowed down to a simpler question. In my opinion, all that the Commissioner meant to do and did was to ensure that the whole matter should be taken up again from the beginning and there is no foundation for the suggestion that because an earlier Income-tax Officer was disposed to fasten on one particular default and said that he might possibly accept the explanation given in regard to others, it means that when a recommencement of the whole proceeding has been directed the subsequent revenue officers are to blind (?) themselves to the obvious facts when the case is taken up again. Accordingly in my opinion, there is no ground on which the assessee could succeed upon either footing. In *A. K. R. P. L. A. Chettiar Firm v. Commissioner of Income-tax, Burma*, it was expressly held by a Full Bench that the only question of law that can arise in such a case as this is whether there was evidence upon which the Assistant Commissioner could have based his order, and the question whether the assessment as made was valid is not a question of law that could arise out of the order of the Assistant Commissioner. For these reasons, I am of opinion that no question of law has arisen in this case, and therefore the application for a mandamus must be dismissed with costs, ten gold mohurs.

DUNKLEY, J.—I am of the same opinion. It seems to me to be clear that when the Commissioner in his order of 30th October 1935 said that the Income-tax Officer abandoned the principal one of the grounds namely, the question of the existence of headquarters accounts, all he meant was that there was no decision upon that question. For that reason he set aside the assessment and ordered the whole proceedings to commence de novo.

Application dismissed.

[IN THE PRIVY COUNCIL].

COMMISSIONER OF INCOME-TAX, BOMBAY
PRESIDENCY & ADEN

v.

CHUNILAL B. MEHTA.

LORD THANKERTON, LORD ROMER, SIR LANCELOT SANDERSON,
SIR SHADI LAL and SIR GEORGE RANKIN.

! June 16, 1938.

INCOME—FOREIGN INCOME—ASSESSEE RESIDING AND CARRY-
ING ON BUSINESS IN BRITISH INDIA—TRANSACTIONS IN FOREIGN
PLACES—PROFITS NOT BROUGHT INTO BRITISH INDIA BUT TRAN-
SACTIONS CONTROLLED FROM BRITISH INDIA—PROFITS WHETHER
ACCRUE OR ARISE IN BRITISH INDIA—ASSESSABILITY—BUSINESS
INCOME, WHETHER NECESSARILY ACCRUES WHERE BUSINESS IS
CARRIED ON—ENGLISH AND INDIAN LAW—INDIAN INCOME TAX
ACT (XI OF 1922), SECS. 4, 6, & 10.

Under the Indian Income Tax Act a person resident in British India carrying on business here and controlling transactions abroad in the course of such business is not by these mere facts liable to tax on the profits of such transactions. If such profits have not been received in or brought into British India it becomes or may become necessary to consider on the facts of the case where they accrued or arose.

The mere fact that profits arising under contracts made abroad depend on the exercise in British India of knowledge, skill and judgment on the part of the assessee and upon instructions emanating from British India does not involve that the profits arose or accrued in British India. It makes no difference whether the transactions are dealings in goods or are dealings in differences.

There is no necessity arising out of the general conception of a business as an organisation that profits of the business should arise only at one place, namely, the place of central control of the business. Sections 4, 6 and 10 of the Indian Income Tax Act do not also lead to any such conclusion. These sections do not mean that the situation of the source of the profits should determine the place where the profits arise. The profits of each particular business are to be computed wherever and by whomsoever the business is carried on, but only on condition that they are profits accruing, arising or received in British India or deemed to be such. The

sections lay no stress on the place at which the business is carried on, and do not lay down that the profits necessarily accrue or arise at the place where the business is carried on.

The English Act imposes tax upon all who exercise a trade within the United Kingdom and observations of English Judges by way of exposition of this policy cannot be authority on the problem under the Indian Act.

Decision of the Bombay High Court in Commissioner of Income-tax, Bombay v. Chunilal B. Metha (1935 I.T.R. 376) affirmed.

Cases referred to :

AURANGABAD MILLS, LTD., *In re* [1921] (1 I.T.C. 116; 64 Ind. Cas. 9; A.I.R. 1921 Bom. 159; 45 B. 1286; 23 Bom. L.R. 570).

COMMISSIONER OF INCOME TAX v. SHAW WALLACE & Co., [1932] (59 I.A. 206; 136 Ind. Cas. 742; 59 Cal. 1343; 9 O.W.N. 515; 36 C.W.N. 693; A.I.R. 1932 P.C. 138).

COMMISSIONER OF INCOME TAX, BOMBAY v. SARUPCHAND HUKUMOHAND [1931] (55 B. 231; A.I.R. 1931 Bom. 236; 5 I.T.C. 108).

ERICHSEN v. LAST [1881] (8 Q.B.D. 414; 51 L.J.Q.B. 86; 45 L.T. 703; 30 W.R. 301; 46 J.P. 357).

JIWAN DAS v. INCOME TAX COMMISSIONER, LAHORE [1929] (4 I.T.C. 40; 117 Ind. Cas. 657; A.I.R. 1929 Lah. 609; 30 P.L.R. 489; 10 Lah. 657; Ind. Rul. (1929) Lah. 673).

RAMANATHAM CHETTI, *In re* 1 I.T.C. 37.

RIPON PRESS & SUGAR MILLS, Co., LTD. *In re* [1923] (1 I.T.C. 202; 77 Ind. Cas. 621; 46 M. 706; A.I.R. 1923 Mad. 574 (F.B.)).

ROBINSON BROTHERS (BREWERS), LTD. v. ASSESSMENT COMMITTEE (1938) 54 T.L.R. 568 at p. 571.

SULLEY v. ATTORNEY-GENERAL [1860] (5 H & N 711 at p. 717; 29 L.J. Ex. 464; 120 R. R. 793; 157 E.R. 1364).

Appeal from a judgment of the Bombay High Court reported as 1935 I.T.R. 376.

J. Millard Tucker, K. C., Hubert Hull and J. Megaw, for the Appellant.

A. M. Latter, K. C., and R. P. Hills, for the Respondent.

JUDGMENT.

SIR GEORGE RANKIN.—The High Court at Bombay has answered in favour of the respondent assessee two questions of law formulated and referred to the Court by the Commissioner of

Income-tax (Bombay Presidency and Aden) under Section 66 of the Income-tax Act, 1922. The assessee is resident in British India and the year of assessment is the year ending March 31, 1934. By order dated December 13, 1933, the Income-tax Officer assessed the respondent on a total income of Rs. 12,95,726 the total demand for income-tax and super-tax being Rs. 7,18,472. This order was confirmed by the Assistant Commissioner on January 19, 1934. By these orders the assessee was held liable to pay tax upon profits derived by him from contracts made for the purchase and sale of commodities in various foreign markets—Liverpool, London, New York and elsewhere outside British India. The assessee disputes his liability in respect of such profits on the ground that they were not profits “accruing or arising in British India”. It is conceded that they are not otherwise chargeable: they have not been received in British India nor do they come under any of the provisions whereby they can be deemed to accrue or arise or be received in British India.

No question arises as to the details of the transactions or as to the calculation of the tax. Though the transactions appear to have been of a speculative character and of the kind compendiously described as “dealing in futures”, it is not now sought to charge the assessee upon the basis of any allegation that his contracts were made by way of gaming and wagering. In case, however, the place at which the profits accrued or arose should be held to depend upon the facts as to delivery of goods thereunder or intention to deliver the question propounded to the Court was stated in a double form as follows:—

“(1) Whether in the circumstances of the case all the profits and gains which accrued and arose to the assessee from the business of future delivery contracts entered into with parties outside British India in which no delivery was ever taken or given, or any part of such profits and gains can be said to have accrued or arisen in British India.”

“(2) Whether as regards that part of the said business of future delivery contracts in which delivery had been actually given or taken outside British India, the profits or gains which accrued can be said to have accrued wholly or partly in British India or otherwise.”

As it is found that in no case was the taking or the giving of delivery done within British India, the second question is separately stated in the interest of the assessee and on the footing that to

it an answer might be given more favourable to him than the answer to the first. This indeed was the view of the Commissioner. In his opinion the answer to the first question should be that all the net profits and gains from these contracts (after payment of the services rendered by the brokers outside British India) accrued or arose in British India. To the second question he answered that part only of the profit and not the whole can be said to have accrued in British India. The learned Judges of the High Court were of opinion that the whole of the profits referred to in both questions accrued or arose outside British India. Their Lordships will confine their attention, in the first place, to the cases mentioned in the first question, postponing the second.

The narrative given by the Commissioner in his Letter of Reference to the High Court contains material for a contention that the place at which the assessee entered into the contracts of purchase and sale was Bombay. Before their Lordships this contention was disclaimed by learned Counsel for the appellant whose argument took the forms that the exercise of skill and judgment in and the giving of directions for the formation of the contracts took place in Bombay and that Bombay was the place at which the assessee carried on the business which had produced the profit. This leaves little room for dispute as to the facts of the case, which in the circumstances are sufficiently represented by the following extracts from the Letter of Reference:—

“2. The assessee has been trading in Bombay for several years past as broker and speculator in cotton, silver and other commodities. He has his office in Bombay only. He has also income from properties and dividends on shares in joint stock companies. As regards the speculation business, the assessee does this on his own account as well as on account of his constituents and he carries on his business not only with parties in British India but also with parties outside British India, *e.g.*, at Liverpool, London and New York. Profit or loss from such business as is done on his own account is his. As regards business done on account of his constituents, he charges brokerage and the profit or loss arising therefrom is theirs.

7. As in this connection, it is necessary to have some idea of the exact manner in which the assessee does this speculation business, I beg to refer here to an actual transaction to show how it was put through. Taking up the New York Cotton Exchange, on October 29, 1930, the assessee sent a telegram to A. Norden & Co. of New York asking them to “Buy 500 March at the closing”.

A copy of the telegram is annexed hereto and marked Ex. E. This was done at 11·74 cents per pound (a bale containing 500 lbs), as appears from the reply telegram of the same date which runs "Bought March 500. 11·74" (copy annexed and marked Ex. F). On December 1, the assessee sold the 500 bales by sending again a telegram to the above firm asking it to sell. The telegram ran "Sell 500 March," (copy annexed and marked Ex. G.) The firm did so at 10·84 cents per pound, as appears from the reply telegram of the same date which ran "Sold March 500, 10·84" (copy annexed and marked Ex. H). A copy of letter dated December 1, 1930, from the above firm confirming the sale is also annexed hereto and marked Ex. I. The difference between the purchase and sale price amounted thus to dollars 2,250 which the assessee had to pay along with the amount of dollars 90·21 charged by the firm on account of brokerage and other expenses. The assessee neither paid the purchase price nor recovered the sale price nor did he take or give delivery of the said 500 bales. He paid only the difference between the two prices. (This is also what he would do with a broker in Bombay while dealing with a party here). All that is to be done in a business of this kind is thus merely to issue an order to a broker for forward purchase or sale and then issue another order closing the transaction".

It is not necessary to refer to certain documents which in the case of the Liverpool transactions were sent to Bombay for signature, since these bear solely on the contention not now persisted in that the place of formation of the contracts was Bombay; but the following extract from the opinion of the Commissioner may be added as disclosing his view of the facts:—

"10. As regards question (1), I beg to say that the assessee has got his office here in Bombay alone where he does all the business, the profits of which are to be taxed. Each and every transaction which ended in these profits has been personally managed by the assessee and has not been left to the discretion of any agent of his abroad. These activities on his part which resulted in the profits or gains sought to be taxed all took place in Bombay and nowhere else.....He considered in Bombay the prevailing prices of cotton, silver, etc., at Bombay, London, Liverpool, and New York and made up his mind here to enter into each of the future delivery contracts under consideration.....There must be two parties to a contract. Hence the assessee being one party thereto had to find another party and for that purpose had to employ brokers outside British India but that cannot be interpreted as meaning

that what he earned by his efforts in British India was earned where the brokers were located. The brokers merely helped him in getting into contact with parties willing to enter into a contract with him. Surely the profit which the assessee earned must have accrued somewhere and when everything which he need do to earn it was done by him in Bombay (including employment of brokers which, too, was done from Bombay), it is difficult to see how the profit could be said to have arisen in London or New York where the assessee never set foot. All the activities on his part which resulted in this profit took place in Bombay and the profit which was the result thereof must be taken to have accrued here and nowhere else".

This view, it will be observed, proceeds upon a consideration of the particular transactions and the method by which each transaction was entered into and carried out. But the argument has been heightened or re-inforced by maintaining that the profits now in question being profits of a business carried on in Bombay, all the profits of such business become chargeable to tax as accruing or arising in Bombay, and that it is not necessary or permissible to discriminate between any of such profits for the purposes of the charge imposed by the Act. Profit in the case of a business—so runs the argument—is the result of all the transactions whether plus or minus; not to treat them as a whole is illogical and highly inconvenient: they must all accrue or arise in the same place—the place at which the business is directed or controlled, the place at which the assessee exercises his trade.

If this doctrine be right, much may depend upon the question whether the assessee has carried on one business or more than one. As the Commissioner has stated that the assessee kept separate books for his transactions with parties in British India and with parties abroad, there may be something here not unworthy of a careful consideration. But their Lordships will assume (without in any way deciding) that, whether in fact or in law no difficulty arises in regarding all the assessee's, foreign dealings as part of his Bombay business.

If the profits of the assessee's speculations on the various foreign markets be regarded distributively as separate transactions the question for decision is not inaptly framed by Beaumont, C.J. as follows:

"Does the fact that profits arising under contracts made abroad depend on the exercise in Bombay of knowledge, skill and judgment on the part of the assessee, and upon instructions

emanating from Bombay involve that the profits arose or accrued in British India ? ”

The words “accruing or arising in British India” may be taken, provisionally and in the first place, as an ordinary English phrase which derives no special meaning from the Act. The alternative “accruing or arising in” and the antithesis between these words and the words “received in” or “brought into” afford no safe inference of any special meaning. “Profits . . . accruing or arising in British India” are words which in their ordinary meaning seem to require a place to be assigned as that at which the result of trading operations comes, whether gradually or suddenly, into existence. Though the division is only between British India and the rest of the world, the notion may be difficult to apply to a particular transaction, debits and credits being intangible and not occupying space. But the Revenue authorities who have to disclose reasons good in law for affirming that any profits “arose or accrued in British India” have in the present case two things only to put forward—apart, that is, from the argument as to “business” which will be dealt with separately in this judgment. These two things are (a) the exercise of skill and judgment in Bombay, (b) the giving of the directions from Bombay. It is difficult indeed to see that the place at which a man takes a decision to do something in New York or to ask someone else to do something for him in New York is the place at which arises the profit which results from the action taken in consequence of the decision. And if the place from which he issues his instructions be regarded as a separate element the identity of place is no less difficult to detect. That the profit may be casually attributed to the assessee’s decision is reasonable enough; though it be not the proximate cause nor the whole of the cause, it is, in the chain of causation the link which most deserves the attention of anyone who desires to explain the success of the transaction. For this, and it may be for other purposes, the selective process which ignores the intermediate links is justified. But is the same selective process justified for the purpose of assigning the place at which the result arose? Their Lordships think not. It can hardly be maintained that whatever a man decides upon in Bombay and whatever may be done abroad in pursuance thereof, the profit must necessarily arise in Bombay. One must look at the transaction to see what happened in British India and what happened elsewhere. The intermediate links may be all-important. Here the profit is the difference between a sale and

a purchase both effected in New York and then set off and so far carried out in New York that a New York broker has money in his hands or under his control which, as between himself and the assessee, belongs to the assessee.

To determine the place at which such a profit arises not by reference to the transactions or to any feature of the transactions but by reference to a place in India at which the instructions therefor were determined on and cabled to New York is, in their Lordships' view, to proceed in a manner which cannot be supported if the transactions are to be looked at separately and the profits of each transaction considered by themselves. There is a distinct paradox in the contention that the profits resulting from an order placed in New York would have accrued or arisen in the same place (Bombay) had the order been sent to Liverpool with a like result, but that had the assessee decided on and directed the same New York transaction when in Hyderabad the same profits would have arisen in a different place (Hyderabad). So far, therefore, their Lordships are in agreement with the High Court, and they think that it makes no difference to the result whether the transactions be regarded as dealings in goods or as dealings in differences.

The main contention, however, of the appellant is that the profits of the assessee's "foreign" transactions are but part of the profits of his Bombay business, which must be computed as a whole, all profits and all losses having their effect upon the final figure. The clear and able argument of Mr. Tucker did not seek to contest that in computing the profits of any business under Section 10 of the Act, the Revenue authorities are only entitled to include such profits as accrue or arise or are received in British India, or are to be deemed to be within this clause. Section 10 applies indifferently to a business carried on elsewhere. But, it is said, while that is formally true upon the face of Sections 4, 6 and 10, the principle has to be applied in the case of business profits, that loss or profit is the result of the trade as a whole, that the source of the profit is the business as a business, and that the ultimate and total profit of the business must be regarded as accruing or arising at the place of direction or control. On this view it seems that a business carried on outside British India could have no profits accruing or arising within British India though it might be liable to tax on different principles. So, too, a business carried on in British India could have no profits which did not arise or accrue within British India. The

result is that by sections of the Act which make no mention of the place where the business is carried on, the tax is really levied upon the whole or upon none of the profits of a business according as it is or is not carried on in British India. If and only if the owner of a foreign business be not resident in British India, its profits from any business connection or property in British India are taxable by the special provisions of Section 42.

Their Lordships do not consider that the Indian Income Tax Act is patent of this construction. They will first deal with the argument based on Sections 4 and 6 that the respondent's business is the source of the profits and that the sections require that the situation of the source should determine the place where the profits arise. This, in their Lordships view, is a straining of the sections. The effect of Section 6 is to classify profits and gains under different heads for the purpose of providing for each appropriate rules for computing the amount: its language is "shall be chargeable.....in the manner hereinafter appearing." One of the heads is "Business," which as a head of income stands alongside Salaries, Interest on Securities, Professional earnings and Other sources. True, the classification of income is according to the character of the source, and it has been held that "income, profits and gains" as distinct from casual receipts and from other forms of receipt or enrichment, involve the idea of a periodical money return from a definite source: [*Commissioner of Income-tax v. Shaw Wallace & Co.*]. It may further be said that sub-section (1) of Section 4 having used the word or notion "source", the words which follow "accruing or arising" are language in consonance therewith. But the list of "heads" in Section 6 is a list of sources not in the sense of attributing the income to one property rather than another, one business rather than another, but only in the sense of attributing it to property as distinct from employment, or business as distinct from investment. Sections 4 and 6 taken together say of business profits that they are taxable on certain conditions stated in Section 4 and in a manner to be laid down in a later section. When one comes to that section (Section 10) and not before, a further idea is introduced. "The tax shall be payable by an assessee under the head 'Business' in respect of the profits or gains of any business carried on by him." What is to be learnt from an examination of the language of sub-section (1) of Section 4—income, profits and gains as described or comprised in Section 6 from whatever source derived—is that Section 6 is intended as describing different kinds of profit and

that if the condition "accruing, arising or received in British India, etc." is satisfied by the profits, they will not escape by reason of any quality or circumstance of the source. There may be room for the view that having regard to the sixth head in Section 6 the words "from whatever source derived" are surplusage: even so, they are not there as a guide to the place where profits accrue or arise but to make clear that for another purpose source is irrelevant. There is every presumption that in such a section in an Indian Act the Legislature intends the exact language of the section to be the test of liability. To answer the question, "Do these profits accrue or arise in British India?" by asking another, "What in the sense of Section 6 is the source of these profits and is it situate in British India?" is to divert attention from that to which the statute points and to devote attention to what it discards. Nothing could be easier than to say "from whatever source derived if situate in British India" had this been intended. But it would have been by no means easy to apply. The source of salaries, of interest on securities, of professional earnings, is not readily described as situate anywhere though the place where an employment is carried on, or an investment made, or a salary or fees are earned is a familiar notion. There would have been no difficulty in the case of "property" and with the aid of certain rules, little difficulty, it may be, in the case of "business". But the Legislature has chosen a different test and applied it to all kinds of profits—"accruing or arising in British India". It may even have chosen it as fairer because it could be applied distributively to the profits of a single source. However that may be, the profits of each particular business are to be computed wherever and by whomsoever the business is carried on, but only on condition that they are profits "accruing, arising or received in British India", etc. What connection exists, if any, between place of direction and place at which the profits arise is a matter not touched by Section 4, 6 or 10. Not only do they lay no stress upon the place at which the business is carried on: they make no mention of it. In these circumstances it cannot be held that it is itself the test of chargeability by virtue of a rule, not mentioned either, that profits arise or accrue at the place where the business is carried on.

The argument from the use of the word "source" in the Act is supported by appeal to principle, and cases under the English Act have been referred to on the matter. It would be both unreasonable and ungrateful to complain of the use made, by learned

Counsel on both sides, of the English decisions, but their Lordships have carefully to remind themselves that "the Indian Act is not *in pari materia*, it is less elaborate in many ways, subject to fewer refinements, and in arrangement and language it differs greatly from the provisions with which the Courts in this country have had to deal": (per Sir George Lowndes in the case of *Commissioner of Income-tax v. Shaw Wallace & Co (supra)*). The English Act has for many years imposed the tax upon all who exercise a trade within the United Kingdom and observations of English Judges by way of exposition of this policy cannot be authority on the problem under the Indian Act. In any case their Lordships are not satisfied that apart from the dictate of any statute, authority in England has established the proposition that the place at which profit accrues or arises is the place of central control. COCKBURN, C. J., in *Sulley v. Attorney-General* indeed observed:—

"Wherever a merchant is established, in the course of his operations his dealings must extend over various places; he buys in one place and sells in another. But he has one principal place here he may be said to trade—*viz.*, where his profits come home to him. That is where he exercises his trade."

But the question here is whether under the Indian Act the place where certain profits did not come home to him is the place at which they accrued or arose. There seems to be no necessity arising out of the general conception of a business as an organisation that profits should arise only at one place. This indeed seems to have been the view of COCKBURN, C. J., in the case cited (*cf.* p. 716). Their Lordships have also been referred to an observation by Lord Macmillan in *Robinson Brothers (Brewers), Ltd. v. Assessment Committee*:—

"In the case where the brewer sells his own beer in the public house which he rents, he no doubt benefits his brewery by having an assured channel for the disposal of his beer, but the profit is actually made where the sales are effected—that is, in the public house."

No doubt, if it can be held that under the Indian Act profit in the case of a business must be taken so strictly that it is not to be understood distributively at all, the profit of the assessee's business would become an ultimate and single figure, irreducible, and referable only to Bombay. But such a high doctrine cannot be read into the Indian statute without violence not only to its language but to its scheme. Profits are frequently if not ordinarily

regarded as arising from many transactions each of which has a result—not as if the profits need to be disintegrated with difficulty but as if they were an aggregate of the particular results. In the present case assessment order has discriminated between the Bombay and the “foreign” business income. To discriminate between all kinds of profits according to the place at which they accrue or arise is a plain dictate of the statute: other discrimination is involved in the exemptions and in such sections as Section 42.

The construction or application of the Act for which the appellant contends is seen to involve further difficulty if attention be paid to sub-section (2) of Section 4 as it stood after Act XXVII of 1923, and prior to Act XII of 1933:—

“4.—(2) Profits and gains of a business accruing or arising without British India to a person resident in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be profits and gains of the year in which they are so received or brought, notwithstanding the fact that they did not so accrue or arise in that year, provided that they are so received or brought in within three years of the end of the year in which they accrued or arose.

“*Explanation.*—Profits or gains accruing or arising without British India shall not be deemed to be received or brought into British India within the meaning of this sub-section by reason only of the fact that they are taken into account in the balance sheet prepared in British India.”

If this sub-section was solely directed to the case of a person resident in British India being the owner of a business carried on outside British India, no doubt meaning can be given to it without supposing that it was aimed at the foreign part of the business done by persons, firms and companies in India. The reference to the “balance sheet prepared in British India” makes the supposition difficult and their Lordships do not think that the amendment of 1923 was based upon or is consistent with the view that all the profits of a business carried on in British India accrue or arise in British India.

So, too, even if it be right that a business carried on outside can have no profits which accrue or arise within British India, much of the profits of business done in British India by firms abroad would be taxable under Section 42 (1) as “accruing or arising whether directly or indirectly through or from any business connection or property in British India”. But apart from the difficulty of supposing that all such profits are within the sub-section, there is the

important fact that the sub-section does not apply at all where the assessee is resident in British India: such a person owning a foreign business would escape altogether. Of course it may be that a resident would be more likely to bring the profits into British India, but even so if the appellant's view is sustained, a leakage which can hardly have been intended must result. Their Lordships have no hesitation in saying that the sub-section is more readily intelligible as an addition to a provision which catches profits arising in British India to businesses carried on outside.

These considerations lead their Lordships to the conclusion that under the Indian Act a person resident in British India carrying on business there and controlling transactions abroad in the course of such business is not by these mere facts liable to tax on the profits of such transactions. If such profits have not been received in or brought into British India it becomes or may become necessary to consider on the facts of the case where they accrued or arose. Their Lordships are not laying down any rule of general application to all classes of foreign transactions, or even with respect to the sale of goods. To do so would be nearly impossible and wholly unwise—to use the language of Lord Esher in *Erichsen v. Last*. They are not saying that the place of formation of the contract prevails against everything else. In some circumstances it may be so, but other matters—acts done under the contract, for example—cannot be ruled out *a priori*. In the case before the Board the contracts were neither framed nor carried out in British India; the High Court's conclusion that the profits accrued or arose outside British India is well-founded.

The consideration that the view now taken by their Lordships would appear to have been accepted hitherto in India is one which they mention last as the question is raised as one construction of a statute. But it would be paying less respect than is due to the decision of the Indian Courts if mention were not now made of the cases of *In re Ramanathan Chetti*, *In re Aurangabad Mills, Ltd.*, *In re Ripon Press & Sugar Mills, Co., Ltd.*, *Jiwan Das v. Income tax Commissioner, Lahore*, and *Commissioner of Income-tax, Bombay v. Sarupchand Hukumchand*. These and other cases have been fully considered by the Board. The construction which the appellant seeks to put upon the Act has no direct support from them and the main current of authority in India is consistent therewith.

No separate consideration of the second of the questions referred to the High Court is required. Their Lordships will humbly advise His Majesty that this appeal should be dismissed with costs.

Appeal dismissed.

[IN THE LAHORE HIGH COURT].

NAGIN CHAND SHIV SAHAI

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON, ACTG. C. J., and DIN MOHAMMAD, J.

May 5, 1938.

PENALTY—CLAIMING FALSE DEDUCTION—WHETHER LIABLE TO PENALTY—‘INCOME’, MEANING OF—INDIAN INCOME TAX ACT (XI OF 1922), SECTION 28.

If any assessee claims a false deduction he is liable to the penalty imposed by section 28. The word ‘income’ is not used in Section 28 of the Indian Income Tax Act in the popular meaning of money received, but is used in a much wider sense and connotes the assessable figure arrived at after accounting for all the legitimate deductions and exemptions.

Civil Miscellaneous No. 99 of 1938.

Petition under Section 66 (3) of the Income Tax Act, praying that the learned Commissioner of Income Tax, Punjab, may be required to refer certain questions of law arising in the case, to the High Court of Lahore.

D. N. Aggarwal for the petitioner assessee.

S. M. Sikri and *A. R. Aggarwal* for *J. N. Aggarwal* for the Commissioner.

ORDER.

This case turns upon the construction to be put upon the word ‘income’ as used in Section 28 of the Income Tax Act. By that section the income tax authorities are empowered to impose a penalty upon any assessee who “has concealed the particulars of his income or has deliberately furnished inaccurate particulars of such income”.

The petitioner before us avers that the word “income” as used in this section means money received by the assessee and does

not refer to any deduction or exemption claimed by him under the provisions of the Income Tax Act. In other words, he contends that the word 'income' has been used in this section in its popular sense. The income tax authorities on the other hand maintain that the word 'income' has been used in this section in a much wider sense and it connotes the assessable figure arrived at after accounting for all the legitimate deductions and exemptions and consequently if any assessee furnishes any false particulars about any item which is to be accounted for before the assessable figure is arrived at he brings himself within the clutches of the law.

In order to determine the true connotation of the term 'income' as used in the Income Tax Act it will be necessary to refer to the various sections in which this term has been used. Section 2 (15) defines the term 'total income' as "total amount of income, profits and gains from all sources to which this Act applies computed in the manner laid down in Section 16." Section 3 determines all the income, profits or gains chargeable to income-tax. Section 4 lays down that the Income Tax Act applies to all income, profits or gains, as described or comprised in Section 6. Section 6 enumerates the various heads of income chargeable to income tax and Sections 7 to 12 describe the method in which the income under the various heads is to be computed. For example Section 9 dealing with property, Section 10 dealing with business, Section 11 dealing with professional earnings and Section 12 dealing with other sources determine the methods of computing the income under various heads after making the allowances specified therein. Then follow certain exemptions which specify the items of income which are not subject to income tax. Section 16 lays down the method of computing the total income of an assessee. Section 22 (2) provides for the return of income to be submitted by the assessee and Sections 23 (1) and (3) authorise the Income-Tax Officer to assess the total income and determine the sum payable by an assessee on the basis of his return. It would thus appear that the word 'income' in all these sections has not been used in its dictionary meaning, but in a technical sense. These sections are then followed by Section 28 which, as stated above, is a penal section and provides for a safeguard against false returns. If the interpretation put upon the word by the assessee be adopted it would lead to absurd and anomalous results. An assessee would in those circumstances be at liberty to forge his return with impunity in any manner that he likes so far as the expenditure, deduction or exemptions are concerned and would escape the consequences of

the law so long as he furnishes true particulars of his income in the narrower sense of the term. This, however, could never be the intention of the Legislature.

We are fortified in our conclusion by the remarks made by their Lordships of the Privy Council in *Commissioner of Income Tax v. Sir S. M. Chitnavis* (59 I.A. 295-97). That case is on all fours with the present case inasmuch as it particularly relates to bad debts. Those remarks are:—

“Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to income-tax in respect of a business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains”.

Falsehood in accounts can take only two forms: either an item may be suppressed dishonestly or an item may be claimed fraudulently, and in penalising concealment of the particulars of one's income as well as deliberate furnishing of inaccurate particulars, Section 28 penalizes both forms of falsehood. In the case before us it has been found as a fact that the assessee deliberately claimed a false deduction and in the light of the remarks made above, we are disposed to hold that the case of the assessee fell within the ambit of Section 28. We accordingly dismiss this petition with costs.

Petition dismissed.

[IN THE PATNA HIGH COURT].

COMMISSIONER OF INCOME-TAX, BIHAR & ORISSA

v.

SIR RAJENDRA NARAYAN BHANJA DEO OF KANIKA.

WORT, ACTING CHIEF JUSTICE, and DEAVLE, J.

May 5, 1938.

IMPARTIBLE ESTATE—INCOME OF ESTATE IN THE HANDS OF HOLDER OF ESTATE—WHETHER INCOME OF JOINT HINDU FAMILY OR INDIVIDUAL—MODE OF ASSESSMENT—SUPER-TAX—INDIAN INCOME TAX ACT (XI of 1922), SEC. 3.

The income of an impartible estate in the hands of the holder is to be assessed on the footing that the income is the income of an individual and not of an undivided family.

Raja Shiva Prasad Singh v. The Crown (I.L.R. 4 Pat. 73) and *Commissioner of Income-tax, Madras v. Raja of Bobbili* (I.L.R. 1937 Mad. 797) followed; *Commissioner of Income-tax, Bihar & Orissa v. Raja of Bobbili* (I.L.R. 14 Pat. 785) distinguished; *Kishan Kishore v. Commissioner of Income-tax, Lahore* (I.L.R. 14 Lah. 259) not followed.

Case stated under Section 66 (2) of the Indian Income-tax Act (XI of 1922) by the Commissioner of Income-tax, Bihar & Orissa. [Mis. Judicial Case No. 16 of 1937].

STATEMENT OF CASE.

" I have the honour to refer the following case for the decision of the Honourable the Judges of the High Court under Section 66 (2) of the Indian Income-tax Act (XI of 1922) hereinafter referred to as the Act).

2. Sir Raja Rajendra Narain Bhanj Deo (hereinafter stated as the petitioner) is the present holder of the Kanika estate in Orissa. During the previous year (April 1931 to March 1932) he was also a member of the Governor's Executive Council in Bihar and Orissa. For the assessment year 1932-33 the Income-tax Officer, Cuttack, computed the petitioner's total income for assessment to tax as follows:—

Government salary			Rs.	58,500
Interest on taxed securities			Rs.	31,500
Interest on tax-free securities			Rs.	15,540
Property			Rs.	5,277
Business			Rs.	18,824
Other sources				
	Dividend	Rs.	176	Rs. 19,586
	Sairat	Rs.	19,370	
				Total Rs. 1,49,187

The above total income having been ascertained, income-tax and super-tax were levied upon the petitioner as an 'Individual' and a demand notice issued accordingly.

3. Thereupon the petitioner filed an appeal under Section 30 of the Act before the Assistant Commissioner of Income-tax, Southern Range, Purulia, wherein he objected to various items in the computation of the Income-tax Officer, and amongst others contended (1) that he was not liable to tax on his sairat income, and (2) that his status should have been taken to be that of the

head of a "Hindu undivided family". The Assistant Commissioner disallowed both these contentions.

4. Being dissatisfied with the Assistant Commissioner's order the petitioner requires me to state a case on the following three questions of law :—

1. "In view of the treaty engagement (Raooinama) dated the 22nd November 1803, granted by the honourable East India Company, the predecessor in Government of the present Government of India, and in view of the fact that the income from the fisheries, Ferry, Market, Bones and hides (sairat) are income of the "Rajah" of "Rajgee of Killd" Kanika, whether the petitioner's income from sairat is assessable to income-tax."

2. "Whether the income from salary of the petitioner should be included in this assessment or separately assessed?"

3. "In view of the facts that estate of the petitioner is an impartible Raj and the petitioner is governed by the law of Mitakshara and is the head of a family consisting of himself and his son and others, whether the super-tax in this assessment should be calculated as on a Hindu Joint family or Individual?"

Question (1) has already been decided by the High Court against the petitioner in M.J.C. No. 9 of 1935 and need not therefore be referred again.

Questions (2) and (3).—It is not disputed that the petitioner's income from salary was received by him as an 'Individual' in which capacity he has been assessed. But the petitioner considers that he ought to have been assessed as the head of a Hindu undivided family and that the income from salary should not have been included in that assessment. The real point in dispute is whether the petitioner's income other than that received by him as Government salary is his income as an individual or as the head of a Hindu undivided family. These other items of income are the income of the impartible estate of which the petitioner is the owner. The petitioner declares that he is the head of a Hindu undivided family, the income from the estate should be treated as the income of the undivided family. The question as to whether the income of an impartible estate is the income of the Hindu undivided family of which the owner is the head or the income of the individual who owns it was considered by the Patna High Court in the case of *Rajah Jyoti Prasad Singh* (Srinivasan's I. T. Cases I. 386,) and it was decided that the income was that of the incumbent of the estate for the time being and not that of the Hindu undivided family. The same point came up again very recently

before the Madras High Court, in the case of *The Commissioner of Income-Tax, Madras v. Sri Ravu Swetachalapati Ram Krishna Ranga Rao, Raja of Bobbili* and in the judgment passed on 18th December 1936, the Madras High Court also held that the income of impartible estate was that of the individual and not that of the Hindu undivided family. I therefore submit that the answer to question (2) should be that the salary has been rightly included in the assessment made on the petitioner as an individual for 1932-33 and that the answer to question (3) should be that as the entire income of the petitioner including that from his impartible estate is income of an individual, super-tax was rightly calculated on that basis.

S. M. Gupta, for the Commissioner of Income Tax.

Sir Manmatha Nath Mukerjee and *G.C. Das*, for the Assessee.

JUDGMENT.

WORT, A. C. J.—This is a case stated by the Commissioner of Income-tax in the form of three questions. The third question only has been discussed before this Court and with regard to the other two questions they are not pressed.

The third question is: "In view of the facts that the Estate of the petitioner is an impartible Raj and the petitioner is governed by the law of Mitakshara and is the head of a family consisting of himself and his son and others, whether the super-tax in this assessment should be calculated as on a Hindu joint family or individual." The Income-tax Authority has assessed the income of the Raja of Kanika as an individual and not as the income of a joint Hindu family; the particulars of the income it is not necessary to state. The facts are sufficiently indicated by the question itself.

The only matter that strictly arises before us is whether circumstances exist which would necessitate our referring this matter to a Full Bench as there is a decision of this Court on the point against the assessee. I refer to the decision of *SIR DAWSON MILLER, C. J.*, and *FOSTER, J.*, *Sri Raja Shiva Prasad Singh v. The Crown* (I.L.R. 4 Patna, 73) in which it was decided that the income of the holder of an impartible Raj was to be assessed as the income of an individual and not as the income of the Joint Hindu family. This decision has been approved of by the learned Judges of the Madras High Court in *The Commissioner of Income-tax, Madras v. The Honourable Sri Ravu Swetachalapati Ramakrishna Ranga Rao Bahadur, Raja of Bobbili* (I.L.R. 1937 Mad. 797) in which reference was made also to the decision of this

Court in *Commissioner of Income Tax, Bihar and Orissa v. Maharajdhiraja Kumar Bisheswar Singh* (I.L.R. 14 Pat. 785) a case on which Sir Manmatha Nath Mukherji relies for his contention that the earlier decision of this Court has in effect been overruled. The case to which I have just made reference was a case in which an allowance was made by the Maharajdhiraja to his younger brother of Rs. 48,000 per annum and the question arose whether the sum was received by the younger brother as a member of the Hindu undivided family within the meaning of Section 14 sub-section (1) of the Income Tax Act? It was decided that it was. Sir Owen Beasley pointed out in the Madras Case to which I have referred in making reference to this later decision of our Court that the fact that the allowance was paid out of the joint family property was not controverted in that case; and as stated in the leading Judgment, the Court had not to consider the nature of the income from the impartible estate in the hands of the holder. It would be impossible to say that AGARWALA, J., who delivered the leading Judgment in the case reported in the Fourteenth Volume of the Patna Series, has considered the question of the nature of the income in the hands of the holder of the impartible estate. Had it been otherwise, it certainly would have had a direct bearing upon the decision in the Fourth Volume of the Patna series to which I have made reference and which is, as I have already indicated, binding upon this Court. The necessity for reference to a Full Bench does not arise, in my judgment, by reason of the fact that in a Divisional Court decision of the Lahore High Court in *Krishna Kishore v. Commissioner of Income Tax*, (I.L.R. 14 Lahore, 255) another view has been taken. The point is clearly concluded by the decision of this Court, and I would therefore answer the third question submitted to this Court in the following manner :—

“The income of the impartible Raj in the hands of the holder is to be assessed on the footing that the income is the income of an individual and not of an undivided family”.

The Crown is entitled to costs; hearing fee ten gold Mohars.

DEAVLE, J.—I agree.

Reference answered accordingly.

[IN THE COURT OF APPEAL.]
HUGHES (INSPECTOR OF TAXES)

v.
BANK OF NEW ZEALAND *.

LORD WRIGHT, M. R., ROMER, L. J., GREENE, L. J.

December 3, 4, 7, 8, 9, 10, 1936.

REVENUE—INCOME TAX—BANK RESIDENT IN NEW ZEALAND
—WAR LOAN, INDIA STOCK AND COLONIAL SECURITIES HELD BY
IT—INCOME OF LONDON BRANCH—EXEMPTION OF INTEREST FROM
TAX—TRADING EXPENSES—RIGHT OF DEDUCTION FROM PROFITS
FOR ASSESSMENT PURPOSES—INCOME TAX ACT, 1918 (8 & 9 Geo. 5
c. 40), Sec. 46—Sch. C, General Rules, r. 2 (d)—Sch. D, Miscel-
laneous Rules, r. 7, sub-r. (2)—Finance Act, 1934 (14 & 15 Geo. 6
c. 21), Sec. 27.

A bank registered and resident in New Zealand was assessed to income-tax for the year 1927-28 under Case I of Schedule D in the sum of £ 94,448 on the profits arising from the business of its London branch, the assets of which included holdings of 5 per cent. War Loan, India Government 3 per cent. Stock, and securities of the Grand Trunk Pacific Railway and the Auckland Electric Power Board, all purchased partly out of the floating capital of the branch and partly out of moneys obtained in New Zealand, to borrow which it had expended £ 41,262. In the period in question, these holdings produced £ 78,556 interest:—Held, (1) that this interest was absolutely exempt from income-tax; the War Loan interest under Section 46 of the Income-tax Act, 1918, the Indian Government Stock under rule 2 (d) of the General Rules applicable to Schedule C and the interest on the Colonial securities under rule 7 of the Miscellaneous Rules under Schedule D; (2) that this interest was not taxable as trading profits under Case I of Schedule D; (3) that though this interest was exempt from taxation the bank was entitled for purposes of assessment to include in its trading expenses to be deducted from profits the sum of £ 41,262 as expenses particularly attributable to earning it.

Cases referred to:

BROWN v. NATIONAL PROVIDENT INSTITUTION [1921] (90 L.J.K.B. 1009; 1921, 2 A.C. 222; 8 Tax Cas. 57).

CADBURY BROTHERS, LTD. v. SINCLAIR [1933] (103 L.J.K.B. 29; 18 Tax Cas. 157).

[Note: This important case is referred to in several recent Indian cases—E d.]

DOWN *v.* MERCHISTON CASTLE SCHOOL, LTD. [1921] (S.C. 853; 8 Tax Cas. 149).

FRY *v.* SALISBURY HOUSE ESTATES, LTD. [1930] (99 L.J.K.B. 403; 1930 A.C. 432; 15 Tax Cas. 266).

INLAND REVENUE COMMISSIONERS *v.* SCOTTISH CENTRAL ELECTRIC POWER Co. [1931] (S.C. (H.L.) 36).

KIRKE'S TRUSTEES *v.* INLAND REVENUE COMMISSIONERS [1926] (1927 S.C. (H.L.) 56; 11 Tax Cas. 323).

LIVERPOOL LONDON AND GLOBE INSURANCE Co. *v.* BENNETT [1913] (82 L.J.K.B. 1221; 1913 A.C. 610; 6 Tax Cas. 327).

STRONG & Co. OF ROMSEY, LTD. *v.* WOODFIELD [1906] (75 L.J.K.B. 864; 1906 A.C. 448; 5 Tax Cas. 215).

THOMPSON *v.* TRUST AND LOAN Co. OF CANADA [1932] (101 L.J.K.B. 342; 1932, 1 K.B. 517; 16 Tax Cas. 394).

UNION COLD STORAGE Co. *v.* JONES [1924] (129 L.T. 512; 8 Tax Cas. 725).

Appeal from a decision of Lawrence, J.

The Bank of New Zealand was registered and resident in the Dominion, where it had its head office. It had a branch office in London and was assessable to income-tax under Schedule D, Case I on profits arising from trade exercised there.

The branch held among its assets in the year 1927-28 holdings of 5 per cent. War Loan, India Government 3 per cent. Stock and the securities of two Colonial companies: the Grand Trunk Pacific Railway and the Auckland Electric Power Board. The interest received was £75,621 on the War Loan, £1,500 on the India Government Stock, £412 from the railway, and £1,023 from the power board, and all was included in the trading receipts in the profit and loss account of the branch. The War Loan interest was paid without deduction of tax and was not assessed to tax under Schedule D, Case III, r. 1 (f). The interest on the other securities was taxed by deduction in the ordinary way, but was repaid to the bank on the ground that the bank was not resident in the United Kingdom, but without prejudice to any of the questions raised on the appeal. A great part of the floating capital used by the bank in its trading at its London branch represented reimbursement to it of money paid out by it in New Zealand to customers there under various operations. During the year in question, on the average of weekly balances, the London branch was indebted to the head office to the extent of £7,099,604. It was

agreed that of this £ 3,520,290 could properly be regarded as forming part of the circulating capital used by the bank in its London branch and derived from money borrowed by the bank in New Zealand, as distinguished from its share capital and reserves. The money used by the bank at the London branch came from international banking business, as well as from direct remittances from the Dominion. The branch collected larger amounts than it paid to the head office and used the balances in the ordinary course of banking business.

The Crown admitted that the bank in computing its liability, to income-tax could deduct, besides the general expenses of the London office, a proportion of the interest paid by it on money borrowed in New Zealand and of the general expenses of the head office there, as representing the cost of obtaining the money by the use of which the London trading receipts were earned, the amount to be deducted being agreed, subject to the questions (1) whether if the interest on the securities already described were excluded from the trading receipts brought into computation any deduction should be allowed for obtaining the money by the use of which it had been earned, and (2) whether a further allowance should be made in addition to the interest and expenses admitted by the Crown, on the ground that part of the profits in the account of the London branch ought not to be treated as profits of a trade exercised in London in view of the operations of the Dominion head office in obtaining the money used in London. The branch accounts for the relevant year showed a balance of profit of £ 116,023, after debiting £ 112,868 for interest and expenses paid in the Dominion in respect of money borrowed there and used at the London branch. This item included £ 41,262 in respect of money borrowed in the Dominion and used to purchase the securities already described. The Crown admitted the £ 112,868 as a deduction for expenditure by the bank if interest amounting to £ 78,556 on those securities were included in the computation of the bank's liability under Schedule D, Case I, and contended that the assessment should be amended to the profit balance of £ 116,023. If the gross amount of the interest were excluded, without any diminution of the expenses allowed to be deducted, the assessable profit was £ 37,467. Alternatively, the Crown contended that if the interest on those securities were excluded, the interest of £ 41,262, paid in respect of money invested in them, should be excluded from the expenses deducted, making the assessable profit £ 78,729. The bank claimed

a further deduction from the London branch profits, on the ground that part should be attributed to New Zealand.

It was contended on its behalf that (a) that the Income-tax Act, 1918, Section 46 (1), exempted the 5 per cent. War Loan interest from income-tax; (b) the General Rules applicable to Schedule C, r. 2 (d) exempted the India Government Stock interest and the Miscellaneous Rules applicable to Schedule D, r. 7 (2) exempted the interest on the Colonial securities; (c) that these exemptions were absolute and these interests could not be taxed indirectly as trading receipts under Schedule D; (d) that in reaching the balance of the profits of its trade in London for the purposes of assessment under Schedule D, Case I, the bank was entitled to deduct all expenses incurred in earning them, without regard to the taxation or exemption of any item; (e) that the whole cost of obtaining the money used in earning the profits of the London trade should be deducted in computing liability under Schedule D, Case I; (f) that part of the profits of the London branch was attributable to the bank's operation in New Zealand and should be excluded for purposes of assessment.

The Crown contended (a) that the interest on the exempted securities was part of the trading receipts of trade exercised in the United Kingdom and should be included in computation for assessment under Schedule D, Case I; (b) that the Income-tax Act, 1918, Section 46 (1), and rule 2 (d) of the General Rules applicable to Schedule C exempted certain interest paid to persons not resident in the United Kingdom from charge under Schedule C or Schedule D, Case III, but did not exclude trading receipts from computation of the profits of the trade for assessment under Schedule D, Case I; (c) that rule 7 of the Miscellaneous Rules applicable to Schedule D was machinery for assessment and collection of tax and did not extend to the securities of the Colonial companies the exemption conferred by rule 2 (d) of the General Rules applicable to Schedule C; (d) alternatively that if the exemptions were granted diminishing the profits, only the net profits derived from the specified securities should be so exempted, and the cost of obtaining the money used in earning the interest omitted from the trading receipts should not be deducted as a trade expense; (e) that all the profits included in the computation arose from trade in the United Kingdom by the use of money in London and that no other deduction was allowable, save the actual cost of earning them; (f) that the assessment of £ 94,448 made

on the bank should be increased to £116,023, or alternatively should be reduced to £71,729.

The Commissioners allowed the bank's appeal from the assessment, reducing it to £37,467, holding that all the interest on the exempted securities should be excluded from profits for assessment under Schedule D, Case I. They also held that only the actual cost incurred in earning the trading receipts of the London branch could be set off against them in computing the assessable profits from the bank's trade at the London branch, and that no further deduction could be allowed on the ground that a notional profit should be attributed to operations in New Zealand. Lawrence, J., having upheld this decision, the Crown appealed.

The Attorney-General (Sir Donald Somervell, K. C.), and R.P. Hills, for the Appellant.

Latter, K. C., and Scrimgeour, for the Respondent.

LORD WRIGHT, M.R.—In this appeal the Court are all agreed what their decision ought to be. It is a case of importance and of complexity, but, as we are all agreed, I think it desirable to give judgment at once. The taxpayer here, the Bank of New Zealand—the respondent on this appeal—is a bank registered and resident in New Zealand. It carries on, and at all material times did carry on, its banking business in London, but not so as to be resident or ordinarily resident in the United Kingdom. It carries on its banking business at a branch office in London, and there is no question but that, in respect of profits arising from the trade exercised at the London branch office, it is assessable to income-tax under Case I of Schedule D.

The two main questions which have to be decided are: first, What limitations are to be imposed upon those profits. That involves an investigation of certain exemptions which, it is claimed, have to be applied in considering what are the assessable profits under Case I. Then there is a second main question, which arises in the event of the first question being decided against the Revenue, and that is; What deductions are permissible under the rules in order to ascertain the balance of profits and gains under Case I?

There are comparatively few facts which I need detail. There is a summary or skeleton statement of the financial position of the bank, so far as is material for the purposes of this case—that is to say, a statement of the material receipts and expenses of the London branch. That summary of accounts refers to four sets of

receipts on the credit side. The first is interest on 5 per cent. War Loan, amounting to £75,621; the second is interest on India 3 per cent. Stock, which amounts to £1,500; then there are two other items which go together—one is interest on Grand Trunk Pacific Railway Bonds, which is £412, and the other is interest on Auckland Electric Power Board Bonds, £1,023. These four figures are the items about which the dispute centres. On the other side, there are set out working expenses and various other expenses, and a particular matter to which I must refer here is an item "Interest and expenses paid in New Zealand in respect of money borrowed in New Zealand, and used at the London branch"; that total figure is £112,868; but we are only concerned here with a proportionate amount of that figure, namely, £41,262, which is said at this stage in the case to be in respect of money borrowed in New Zealand and used in the purchase of the above-mentioned assets of the London branch, namely, the securities mentioned in the four items of receipts, the four sets of receipts, to which I have already referred. The main charge here is for interest. The money used for the purchase of these various securities in London was part of the floating capital used by the bank in its trading at its London branch, and it is not necessary to consider why. It is a matter of ordinary business. As a matter of accounting between the two sections, between the London branch and the main office, the London branch was debited with these interest charges. They retained these moneys out of amounts collected, and used these balances due to the head office, so far as they retained them, in the ordinary course of their banking business, either for making loans or for purchasing bills or securities in London, the profits derived from that use of the money being included in the accounts of the London branch. One other thing I may mention: the four securities that I have already referred to are different in certain incidence in their character. The War Loan was dealt with by being paid without deduction of tax, and had not been assessed to tax at all so far. The interest on the India Government Stock and on the securities of the two Colonial companies had been taxed by deduction in the ordinary course—that is to say, by the agents who were entrusted by the India Government or the various companies with the payment in these country of the interest on the securities. The tax deducted had been repaid to the bank on the ground that it was not resident in the United Kingdom, but without prejudice to any of the questions raised on the appeal.

The general position is this, that if the Crown succeed on their claim that these four sets of securities are all of them liable to taxation under Case I of Schedule D, the interest will amount to £78,556, and that is the first main question divided into three branches, because different considerations apply to the three classes of securities. Then, if that is decided against the Crown, a further point arises whether the £41,262, which is treated as paid in respect of the money invested in the securities, ought to be excluded in ascertaining the balance of profits and gains under Case I of Schedule D, or whether any part of that should be so excluded.

The Special Commissioners and LAWRENCE, J., have both decided against the Crown and in favour of the taxpayer, the bank. I may say at once that a great many cases have been cited to this Court and a great many arguments have been adduced. If I do not refer in detail to all those cases or to all those arguments, it must not be thought that I have failed to do so out of any disrespect or from any disregard of the cases and the arguments, which I have considered to the best of my ability. But it seems to me many of these authorities and many of these contentions do not really assist in coming to a conclusion on the matters before the Court, and I have, therefore, felt it best to decide the case, as far as I can, on the construction of the relevant sections and on the broad principles which appear to me to be necessary to be applied in construing these sections.

I shall deal first with the matter of the War Loan, because that depends on a quite different set of sections. The position is this: It is not denied by the Crown that the War Loan interest, as interest, is immune from taxation, and, therefore, cannot be taxed as interest either under Schedule C or under Case III of Schedule D. The exemption under the sections to which I shall refer in a moment is admitted, but it is said that the Crown are entitled to disregard the possibility of taxing under the other Schedules or Cases, or to disregard the immunity under the other Schedules, or Cases, and to fix their attention on Case I of Schedule D, and they claim that they are entitled, on any view, to tax under that Case. The question which arises more particularly in the two following classes of interest, but which also arises here (or perhaps arises equally in all three), is that the bank is not a resident, but is a trader, and, therefore, an exception which only applies to it as a non-resident, it is said, has no bearing at all upon the claim to immunity in respect of its position as a trader, because,

as is well known, the essence of liability in questions of this sort is that the taxpayer is carrying on a trade in this country, and it does not matter whether he is resident or not; the essential feature is that he is trading in the country. That is under Schedule D, R. 1 (a) (iii).

It is necessary to consider what is the exemption relied on by the respondent here, and that is to be found as the law now stands in Section 46 (1) of the Income Tax Act, 1918. I ought perhaps to read that section as it is so important in this case. It seems to me to be perfectly clear. It is in these terms: "Where the Treasury have before the commencement of this Act issued or may thereafter issue any securities which they have power to issue for the purpose of raising any money or any loan"—then follow the material words—"with a condition that the interest thereon shall not be liable to tax or super-tax, so long as it is shown, in manner directed by the Treasury, that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom, the interest of securities issued with such a condition shall be exempt accordingly." Then in sub-section 2 there is a provision as to the securities forming part of the investments of a foreign insurance company. That provision I do not think throws any real light on the question here. There is, however, another section to which I ought to refer, and that is Section 49 (2): "The Treasury may direct that any Exchequer bonds, issued under their authority during the continuance of the present war and a period of six months thereafter, and any securities issued under the War Loan Acts, 1914 to 1917, or any Act amending those Acts shall be issued, or shall be deemed to have been issued, subject to the condition that the interest on the bonds and securities shall be paid without deduction of tax, and the interest shall be so paid accordingly, but any such interest shall be chargeable under Case III of Schedule D." I think it is useful without going into the history of this particular line of legislation too minutely, to refer to one section in the Finance Act of 1915, namely, Section 47, which was reproduced in Section 46 of the Act of 1918, which I have just read, but be it noted that Section 47 of the Finance (No. 2) Act, 1915, has not been repealed, and therefore, must be read along with Section 46 of the Act of 1918. It is in these words: "The Treasury may, if they think fit, during the continuance of the present war and a period of twelve months thereafter, issue any securities which they have power to issue for the purpose of raising any money or any loan with a

condition that neither the capital nor the interest thereof shall be liable to any taxation, present or future, so long as it is shown in manner directed by the Treasury that the securities are in the beneficial ownership of persons who are neither domiciled nor ordinarily resident in the United Kingdom, and securities issued with such a condition shall be exempt accordingly." That was slightly modified in Section 44 of the Finance Act, 1916, but for immediate purposes it is necessary, I think, only to refer to Section 46 of the Act of 1918 in this connection.

Section 46 is in my opinion a perfectly general exception; the language is unqualified. It says that the securities are not to be liable to tax or super tax if the Treasury have issued them subject to the condition which is stated. We have been supplied with a copy of the prospectus issued by the Treasury dated 1917 as an illustration of what course is to be taken in these cases, and this is what it says: "Stock and bonds of these loans and the dividends payable from time to time in respect thereof, will be exempt from all British taxation, present or future, if it is shown in the manner directed by the Treasury that they are in the beneficial ownership of a person who is neither domiciled nor ordinarily resident in the United Kingdom of Great Britain and Ireland. Further, the dividends payable from time to time in respect of stock and bonds of these loans will be exempt from British Income Tax, present or future, if it is shown in the manner directed by the Treasury that the stock or bonds are in the beneficial ownership of a person who is not ordinarily resident in the United Kingdom of Great Britain and Ireland, without regard to the question of domicile." I do not read that as throwing any light on the construction of Section 46, but it does seem to me to state correctly what Section 46 means, and to give effect to its terms. If, notwithstanding what I regard as the clear language of this section, it was construed as merely relating to interest as interest, which is the expression used in argument by counsel for the appellant as defining its meaning, with the consequence that the owner of the securities—in this case the bank—can only escape taxation if the tax is sought to be imposed upon him under Case III of Schedule D and that he is liable to be taxed under the provisions of Case I of Schedule D, then it seems to me that a result is being reached which is quite contrary to the apparent meaning of the particular legislation and which, to my mind, involves the very serious frustration of what I imagine the parties, taking the securities from time to time, might be assumed to have contemplated. The

section was put in in 1935, when it was undoubtedly desired to attract subscriptions to loans which were being put forward, as we well remember in those critical years of the War. It seems to me that it would be rather deplorable if, notwithstanding what I regard as the clear language of Section 46, the owner, not being ordinarily resident in the United Kingdom, were still taxed on this War Loan as part of his trading profits, and in my view that is not the true construction of the section. The words of Section 46 are not introduced in respect of any particular Schedule; they are quite general, and that they are quite general is made even more apparent when reference is made to Section 47 of the Finance (No. 2) Act, 1915. I see no ground at all consistent with ordinary principles of construction for cutting down their meaning and treating them as only applicable to Case III of Schedule D, the Case under which by Section 49 War Loan securities were taxable, if they were taxable at all. If they are not taxable at all, then obviously they can neither be charged under Case III Schedule D nor under any Case of Schedule D at all.

As I say, the matter is purely one of construction, and I do not think there is any authority which throws any direct light on a matter of this sort. A reference has been made to the case of *Cadbury Brothers v. Sinclair*, where effect was given to an Act of Parliament—an old Act of 1660—which provided in respect of a particular piece of land that that should be immune from every charge under any public tax. The question arose in a somewhat curious way. Cadbury Brothers, who were occupying the land in question as lessees for the purposes of their business, were held to be debarred from deducting the annual value of the land. In their capacity as occupiers of the land, it was claimed that they were entitled to deduct, in estimating their profits and gains, the annual value of the land which they so occupied for the purposes of their trade, and it was held that if they were not allowed to do that they would be, as occupiers, indirectly taxed to pay a sum of money or otherwise charged in respect of the lands, contrary to the Act of Charles II, and it was held that they were entitled so to deduct it. It was argued that as this land was not separately assessed and charged under Schedule A, because exempted from taxation under the Act of Charles II, therefore the annual value could not be deducted under the well-known provisions of Schedule D, Case I, but that contention was rejected as involving a contravention of the Act giving the immunity, and, in my opinion equally there would be a contravention of Section 46, construed,

as I construe it, in wide terms and as a general exemption if, notwithstanding Section 46, the bank were taxable in respect of their War Loan under Schedule D, Case I, as part of their trading receipts.

In my opinion the effect is that these receipts and interest are taken entirely out of the taxable income of the bank in this country. The ingenious argument of counsel for the appellant started with the proposition that Section 46 only related to interest as such and, further, praying in aid Section 49 (2), contended that the interest in question was transferred to Case III of Schedule D; that the effect of Section 46 was merely to debar the Crown from enforcing that charge and that the Crown were therefore free to charge under Case I of Schedule D as part of the trading profits, notwithstanding the terms of Section 46, which, he said, were irrelevant in this connection, and he relied very strongly on the well-known proposition that the Crown, in certain cases, may elect under which Case of Schedule D—because that is all he is concerned to argue in this Court—they will charge the taxpayer. He relied on *Liverpool, London and Globe Insurance Co. v. Bennett*. In that case, which is very familiar, an insurance company which carried on businesses here and abroad had very large investments in foreign States, as they were required to have under the relevant laws of the States, as the condition of carrying on an insurance business there. They did not bring the interest on those investments home to this country. They received it abroad and did not remit it here. Under the law as it then stood, under the Fourth Case of Schedule D of the Act of 1842, the duty to be charged was only to be computed on the full amount of the sums which had been or would be received in Great Britain in the current year without any deduction or abatement. What the Crown did was to ignore the question of charging under Case IV, because if they had gone to that particular cupboard they would have found that the cupboard was bare; but they decided to charge under Case I, and all the three Courts who tried the case decided that they were entitled to do so. It is sometimes put on the footing that where you have, as you have in Schedule D, a number of Cases, and those Cases overlap, as they do in certain events and in certain matters, and it is more beneficial to the Crown to proceed under one Case rather than under the other, the Crown can choose under which Case they will proceed. For instance, if they proceed under Case I they will be able to tax traders who are non-resident but they will be bound to allow against the amount of the

interest in a case such as that in question the expenses of the business. The interest is part of the receipts and has to be brought into account and, on the other side, the expenses of the business will have to be brought into account. On the other hand, if they charge under Case IV, tax will not be subject to abatement by reason of expenses; they will recover on the basis of the actual interest recovered. In that particular case there was the wider and more convincing reason that there was no taxable subject under Case IV but that, in my opinion, throws no light upon a case like the present. There was no exemption or exclusion in question in that case. It was simply a question of the content of the subject-matter of charge under Case IV. In the case now in question, according to my construction of Section 46 there is a definite exclusion from all taxation and there can be no question at all of taxing either under Case III of Schedule D or under Case I. Whichever cupboard the Crown goes to in the circumstances of this case they will find it entirely bare for purposes of taxation so far as this War Loan is concerned. I agree, therefore, on this issue with the decision of the Commissioners and the Court below.

The next part of the case involves rather different considerations, but again it raises the same question—namely, whether the bank is exempted from taxation by the provisions of the Act in such a way that it cannot be taxed under any specific Schedule—in this case Schedule C—because the bank is a non-resident and, as in the previous case, whether the Crown, notwithstanding such exemption as there is, are still entitled to charge under Case I of Schedule D on the footing that the interest in question constitutes profits of a non-resident trader. The position here depends on the General Rules of Schedule C. The interest of the India Stock in question constitutes profits payable out of the public revenue. There are certain rules applicable to Schedule C which define the content and nature of the charge.

The first body of rules is called General Rules. I need not refer to No. 1, but No. 2 is a rule relied on as embodying the exemption. It says: "No tax shall be chargeable in respect of" certain items, and the first is (a): "The stock, dividends or interest transferred to accounts in the books of the Bank of England in the name of the Treasury or the National Debt Commissioners in pursuance of any Act of Parliament, but the Bank of England shall transmit to the special commissioners an account of the total amount thereof"; and then (b): The "stock, dividends or interest

belonging the Crown in whatever name they may stand in the books of the Bank of England": and then (c): "The stock, dividends or interest of any accredited minister of any foreign State resident in the United Kingdom". The content of (a) has not been very precisely defined by either side, but it is perfectly clear that (b) and (c) are dealing with an absolute exemption. Then comes (d), which is material for the purposes of this case: "No tax shall be chargeable in respect of—(d) The interest or dividends on any securities of a foreign State or a British possession which are payable in the United Kingdom, where it is proved to the satisfaction of the Commissioners of Inland Revenue that the person owning the securities and entitled to the interest or dividends is not resident in the United Kingdom. . . ." Then there are other provisions which I may ignore, but I think rule 3 ought also to be looked at. It is in these terms: "Any bank carrying on a *bona fide* banking business in the United Kingdom shall be relieved, by repayment or otherwise, from tax under this Schedule in respect of the interest on any securities which the bank proves to the satisfaction of the special commissioners to represent subscriptions by the bank to any Government loan issued for the purposes of the present war either before or after the passing of this Act, and the bank shall include the amount of any such interest in the computation of its profits or gains for the purpose of assessment under Case I of Schedule D." That rule 3 affords a striking contrast to the rule which I have just read in rule 2. In the first place it is limited to tax under this Schedule and, in the second place, it provides in terms that the amount of such interest is to be included in any assessment under Case I of Schedule D.

It is contended on behalf of the bank accordingly that rule 2 (d) is not limited to charges under Schedule C but is general in the exemption which it gives and that, therefore, the same result follows in connection with the India Stock, namely, that the owner can claim an exemption if he is able to show to the satisfaction of the Commissioners of Inland Revenue that he is not resident in the United Kingdom.

There are other rules which I may refer to, under the heading: "Rules as to interest, etc., with the payment of which persons other than the Bank of England, the Bank of Ireland and the National Debt Commissioners are entrusted." That will deal with cases under rule 2 (d). There are elaborate provisions dealing with, among other things, the way in which the tax in a case of this sort has to be dealt with. In the first place, the person

responsible for collecting the tax is the person entrusted with the payment of the dividends, and he is under an obligation to make returns to the inspectors appointed by the Commissioners of Inland Revenue, and the Special Commissioners are to have all necessary powers to examine and check the books and accounts of dividends (rule 2), "and shall assess and charge the dividends at the rate of tax in force at the time of payment, but reduced by the amount of the exemptions (if any) allowed by them"—that is by the Special Commissioners—"and shall give notice of the amount so assessed and charged to the person entrusted with payment"—that is to say the agent or nominee of the foreign or Colonial Government who is the person responsible to pay the dividends on behalf of the person entitled thereto and pay the tax to the general account of the Commissioners. That in itself is in one sense machinery but it has this effect, that the tax is not directly chargeable upon the owner of the security, but it is chargeable upon the person entrusted by the foreign or Colonial Government with the duty of paying in England the interest, and though it may be that anyone who is exempt from a liability to pay may have that exemption made effective in the returns provided by the person entrusted with the payment, it is not excluded and it seems to be recognised as proper practice that, if that procedure has in fact taken place, the owner may, in appropriate cases, claim a repayment of the tax deducted. That was done in the present case, as it is stated in the Case: "The interest on the India Government Stock and on the securities of the two Colonial companies had been taxed by deduction in the ordinary course, but the tax deducted therefrom had been repaid to the bank on the ground that it was not resident in the United Kingdom, but without prejudice to any of the questions raised on the appeal."

That being the general position, it is contended on behalf of the Crown that though this provision is effective as regards charges under Schedule C, it has no effect at all as regards an alternative claim under Schedule D, Case I, and, while counsel for the appellant has conceded in this Court, on the basis of *Fry v. Salisbury House Estates, Ltd.*, that he cannot contend that the Crown has a right of election between Schedule C and Schedule D, yet he says it is not necessary so to contend in this case because under the terms of Case III, rule 1 (c), of Schedule D these are "profits on securities bearing interest payable out of the public revenue other than such as are charged under Schedule C." Admitting, as he does, that they are not chargeable under Schedule C, he uses that

sub-rule as bringing the matter within the purview of Schedule D and then he says that the Crown have the right of election to tax under Case I or Case III of Schedule D. I do not, however, follow that his argument is that the exemption would not also apply under Case III, and, if that be so, the curious result would follow that the exemption takes the profits out of Schedule C and transposes them to Case III of Schedule D, without destroying the exemption which would still apply, although, according to the argument, it is limited to Schedule C, with the only practical result that it gives the Crown in that event an option to a charge under Schedule D, Case I. But for various reasons I cannot accept that argument, which appears to me to be very artificial and not well-founded.

The real and final argument against the view which counsel for the appellant put forward is, however, to my mind this, that the exemption under Schedule C, rule 2 (d), is an unlimited exemption, as unlimited as the exemption which I have already discussed in the case of War Loan. I think that appears from the mere language of Schedule C, rule 2 (d); but if there were any doubt about it I think that doubt would be resolved by the consideration that this Act is a Consolidation Act and that Schedule C, rule 2 (d), is, as I think, merely repeating the exception which was given for the first time to securities of this class in Section 71 of the Finance (1909-10) Act, 1910. That exception, which is unlimited in language, cannot be taken as appertaining to any particular Schedule, except on the ground, of course, that there could be no charge on these particular securities except under Schedule C; but the section itself, sub-section 2, runs in these terms: "Income tax shall not be payable in respect of the interest or dividends of any securities of a foreign State or a British possession which are payable in the United Kingdom, where it is proved to the satisfaction of the Commissioners that the person owing the securities and entitled to the interest or dividends is not resident in the United Kingdom." That seems to me to cover any question of income tax in respect of the interest or dividends in question. I think that the effect of that is reproduced in the words "No tax shall be chargeable in respect of: (d) the interest or dividends on any securities of a foreign State or a British possession", and as I regard the exemption in Section 71 (2) as unlimited, so I construe the exemption in Schedule C, rule 2 (d), of the Act of 1919 as equally unlimited. The effect of the exemption is not changed by the mere fact that for purposes of drafting there

is a different arrangement and because rule 2 (d) is placed in the position where it is, and that, I think, sufficiently disposes of the objection and makes it unnecessary to consider any further the somewhat artificial suggestion that the only effect of Schedule C, rule 2 (d), is to remove the tax from Schedule C and put it into Schedule D. Counsel for the appellant, as I understand, has accepted the position, so far as this Court is concerned, that there can be no interchange as between one Schedule and another. He treats that point as decided by this Court in the case of *Thompson v. Trust and Loan Co. of Canada*, and he accepts, so far as this Court is concerned, the views expressed by Lord Atkin in *Fry v. Salisbury House Estates Ltd.*

I should like to read a short passage from that judgment because it is peculiarly applicable to the whole of the argument of the appellant's counsel in this case. Lord Atkin said (99 L.J.K.B., at p. 412; [1930] A.C., at p. 454): "The scheme of the Income Tax Acts is and always has been to provide for the taxation of specific properties under Schedules appropriated to them, and under a general Schedule D to provide for the taxation of income not dealt with specifically." I observe the words "not dealt with specifically", because these taxes are dealt with specifically in the Act of 1918 under Schedule C and, therefore, Schedule D on that basis cannot apply at all. The noble and learned Lord proceeds: "Schedule A provides for the taxation of income derived from property in land: B for income derived from the occupation of land; C for income derived from Government securities; E for income derived from employment in the public service. It is unnecessary to go further back than the Income Tax Act of 1842, the provisions of which were incorporated in every Customs and Inland Revenue or Finance Act up to 1918, when the present Consolidation Act was passed. I need not repeat the familiar Schedules altered and extended by the Act of 1853. It is only necessary to refer to Section 100 of the Act of 1842, which defined the tax to be imposed under Schedule D" and further on Lord Atkin quotes from Schedule D: "'The said last-mentioned duties shall extend to every description of property or profits which shall not be contained in either of the said Schedules (A), (B) or (C), and to every description of employment of profit not contained in Schedule E'. My Lords, nothing could be clearer to indicate that the Schedules are mutually exclusive; that the specific income must be assessed under the specific Schedule; and that D is a residual Schedule so drawn that its various Cases may carry out

the object so far as possible of sweeping in profits not otherwise taxed. For this reason no doubt the actual Schedule was drawn in the widest terms". Then Lord Atkin proceeds, after quoting the words, "Such language covers income from land in Schedule A and from Government securities in Schedule C. Its true meaning is made apparent by Section 100. Moreover, the dominance of each Schedule A, B, C and E over its own subject-matter is confirmed by reference to the sections and rules which respectively regulate them in the Act of 1842. They afford a complete code for each class of income dealing with allowances and exemptions, with the mode of assessment and with the officials whose duty it is to make the assessments. Thus under A and B the assessment and collection is regulated by the general Commissioners; under C the assessment is by Commissioners specially appointed for the purpose; under E the assessment and collection are made in the departments or by the officers of the public corporations concerned; while under D the assessment is regulated by additional Commissioners. I find it impossible to conceive that these various Commissioners had an option to encroach upon the duties of one another, or that the taxpayer was exposed to having his income freed from the restrictions and exemptions imposed by statute under one Schedule in order to be subject to a different set of restrictions and exemptions imposed by statute under another Schedule." Later on, Lord Atkin said (99 L.J.K.B., at p. 413, [1930] A.C., at p. 456): "I am of opinion that income derived by a trading company from investments of its funds, whether temporary or permanent, in Government securities must be taxed under Schedule C, and cannot for the purposes of assessment under Schedule D be brought into account". I will not read any more of that passage, which, I venture to think, is of great importance in considering the various arguments advanced in this case. It is, I think, quite wrong to say that Schedule C, rule 2 (d), is merely dealing with the machinery of collection: not only does it contain an exemption, but, by its terms, it gives a right of repayment if necessary to a person who is not resident in the United Kingdom, and the various rules as to interest, and so forth, which are set out in the second and third sets of rules under Schedule C are rules which, as Lord Atkin points out, deal with substantive matters, namely, the imposition of the charge and the responsibility for paying the charge upon the person entrusted and various ancillary rights and responsibilities which flow from that position.

On this point as a whole my conclusion is that the words of Schedule C, rule 2 (*d*), are sufficient to embody a complete and general exemption in respect of all taxation under the Act of 1918. I am, of course, in this judgment not dealing with super-tax at all, but with matters arising on what used to be called "ordinary income-tax."

I pass now to the third head—namely, the question of the securities of the two Colonial companies. That raises a different question, because in order to deal with that case it is necessary to arrive at a conclusion as to the meaning of rule 7 (1) of the Miscellaneous Rules applicable to Schedule D. If that construction of that rule is held to be of a particular nature, its effect will simply be to throw the income of these particular securities into the same class and into subjection to the same rules as I have held should be applied in regard to foreign and Dominion securities. Whether or not that is so is a matter not without difficulty, but I have come to the conclusion, in agreement with the Commissioners and the learned Judge, that rule 7 (1) has that effect, and that, therefore, the same conclusion applies to these securities as that which applies to those which I have last been discussing.

There are, however, various matters to be considered in order to justify that conclusion. Rule 7 (1) appears, as I have indicated, in the body of Miscellaneous Rules, but I do not think that the position in which, for reasons of draftsmanship or for convenience, a provision appears in an Income-tax Act can in any way be treated as decisive of the scope and effect of the provision. I should like to refer to a passage from Lord Sumner's judgment in *Kirke's Trustees v. Inland Revenue Commissioners*. Lord Sumner was there dealing with the question as to the right of repayment of excess profits duty, and the language which had to be construed was this: "Where any person has paid excess profits duty, the amount so paid shall be allowed as a deduction in computing the profits or gains of the year which included the end of the accounting period in respect of which the excess profits duty has been paid; but where any person has received repayment of any amount previously paid by him by way of excess profits duty, the amount repaid shall be treated as profit for the year in which the repayment is received." That was found in rule 4 (1) of the Rules applicable to Cases I and II of Schedule D of the Income-tax Act, 1918. Lord Sumner dealing with it says this ([1927] S. C. (H. L.), at p. 64; 11 Tax Cas., at p. 332): "The express mandatory terms of the sentence show, in carefully chosen language, that he" (that

is, the person who enjoys this advantage) "is to submit to something by reason of his having previously enjoyed this advantage in the shape of repayment of an amount previously paid by way of excess profits duty. Something which is not a profit, but is only a money repayment; something which may not result in a profit, because although trading goes on there is so great a loss on the year that this repayment does not make up the deficit; something which may not be a trading profit because trading has ceased altogether, nevertheless is to be treated as profit and as profit for the year". Then Lord Sumner a little later proceeds: "I think, therefore, that the word 'treated' is an apt word to impose a charge". Then later Lord Sumner says: "The only difficult point in the case, I think, is the effect of transferring the section, which was contained in one of the paragraphs headed 'Income Tax' in the Finance (No. 2) Act, 1915, into the consolidating Income Tax Act of 1918. The section there becomes one of the rules applicable to Schedule D; and it has been argued, not without force that the true charge in the Income Tax Act is to be found in the first clause and that the rules are only modes of applying the charge previously expressed. The conclusion is drawn that this paragraph, being only a rule, does not operate to prevent the principle of construction of that charge laid down in *Brown v. National Provident Institution* from applying and accordingly the repayment is taken out of any charging words. If, however, it is right to hold that 'treated as profit' involves chargeability as profit, then the mere fact that these words are words of charge additional to the charge at the commencement of the Schedule does not prevent them from being effectual as a charge or render that part of their full meaning surplusage. All that has happened is that there are two statements as to chargeability, and the words 'treated as profit for the year' still contain a specific charge". I rely on that statement involving this, that the Court must consider the exact language and effect of a provision such as that now in question in rule 7 (1). Though the fact that the provision merely appears in one of the rules and not in a part of the Act which is ostensibly and specifically of a charging character is something which ought to be borne in mind, and even, to some extent, raises the presumption that no charge is intended, yet if the effect on the true construction of the rule is that it does embody a charge, then the rule must be construed accordingly. Now, I think that rule 7 (1) cannot be construed in any other way than as imposing a charge with limitations and qualifications.

and Dominion securities, because the latter were subject to the special exemption under Section 71 (2) of the Finance (1909-10) Act, 1910, and, therefore, it is easier and simpler in a Consolidation Act like the present to construe the exemption in the Act of 1918 as having the same effect and scope as the exemption given by the Act of 1910. There is certainly some force in that argument. *Prima facie*, as I have already said, a Consolidation Act merely consolidates, and, generally speaking, ought to be construed so as not to change the existing law. But it may change the law. It has to be construed according to its own language, and if its language can only be construed in one way, then it must be construed as changing the law. There is every reason why all the provisions of Schedule C should apply to the very analogous case of this foreign interest intrusted to a person in the United Kingdom. The position is identical for practical purposes with that in respect of the interest on foreign Government securities. Although I think it is true to say that Section 71 (2) of the Finance (1909-10) Act, 1910, does not deal with these securities at all, still that may have been a *casus omissus* which the draftsman in framing the Consolidation Act might well have made good when the law was consolidated, as it was, in 1918. However that may be, I think that this rule ought to be construed as counsel for the respondent bank has contended, though I do not accept his argument that under the various provisions of the Act of 1853, and so on, it is possible to treat Section 71 of the Act of 1910 as extending to the particular securities of this character.

There is, however, one further point which is of significance, and which, in my opinion, confirms the view at which I have arrived on the construction of the Act of 1918 and of Rule 7. In the Finance Act of 1924, Section 27, there is an important provision giving a right of appeal in certain cases from the decision of the Commissioners of Inland Revenue to the Special Commissioners, where the taxpayer is aggrieved by the decision of the Commissioners of Inland Revenue on any question of domicile or residence affecting him. In sub-section 3 you have this provision: "This section applies to the following questions:—(a) any question as to ordinary residence arising under sub-section (1) of Section forty-six of the Income Tax Act, 1918". That, it will be remembered, deals with the question which has already been discussed in this case: the language used in the Act is "ordinary residence". Then: "(b) any question as to domicile or ordinary residence arising under paragraph (a) of Rule 2 of the Rules appli-

cable to Case IV of Schedule D, or under paragraph (a) of Rule 3 of the Rules applicable to Case V of Schedule D." These again are exemptions in which the expression is "domicile" or "ordinary residence". Then: "(c) any question as to residence arising (i) under paragraph (d) of Rule 2 of the General Rules applicable to Schedule C; or" (and this is the material passage) "(ii) under Rule 7 of the Miscellaneous Rules applicable to Schedule D in connection with a claim for repayment of income tax made to the Commissioners of Inland Revenue by the person owning the stocks, funds, shares or securities and entitled to the income arising therefrom, or entitled to the annuities, pensions or other annual sums, as the case may be, and from whose income a deduction has been made on account of the income tax assessed and charged under the said Rule." That provision (c) (ii) treats rule 7 as containing a provision in the terms set out. Now these terms which are set out are the exact terms to be found in General Rule 2 (d) of Schedule C, and they can only be found in Rule 7 of the Miscellaneous Rules under Schedule D if rule 7 has incorporated in virtue of the provisions of sub-section 2 the terms of General Rule 2 (d) of Schedule C, to which I have just referred, and that is exactly the conclusion that I have arrived at merely on the construction of the rule itself in the Act of 1918. That provision is not merely a statutory confirmation or recognition, as it were, of what the construction of rule 7 was thought or intended to be, because under Part III of the Act it is, among other things, provided that "Part II of this Act" (that is the Part in which the section to which I have been referring occurs) "shall be construed together with the Income Tax Acts", and therefore you cannot construe rule 7 without reading into it the provisions of this section of the Act of 1924 to which I have already referred. There is one other section in the Finance Act, 1926, which points to the same conclusion, and it is Section 5 of Part II of the Second Schedule, which says (sub-section 1): "Any person who is intrusted with the payment of any interest, dividends or other annual payments which are payable to any persons in Great Britain or Northern Ireland out of the public revenue of the Irish Free State or out of or in respect of the stocks, funds, shares or securities of any Irish Free State company, society, adventure or concern shall be relieved from the obligation imposed on him by General Rule 1 of Schedule C and Miscellaneous Rule 7 of Schedule D to pay tax thereon on behalf of the persons entitled thereto as regards any such interest, dividends or other annual payments in respect of

Of the cases in question that have been referred to, there is *Dow v. Merchiston Castle School, Ltd.*, *Union Cold Storage Co. v. Jones, Strong & Co., of Romsey, Ltd. v. Woodifield*, and *Inland Revenue Commissioners v. Scottish Central Electric Power Co.* In none of these cases do I find any help for the problem now put before the Court. The expenses which are dealt with here by the Commissioners are interest on the money borrowed and used to purchase these particular securities, and it would be a suitable conclusion if that could be deducted. There are also, however, expenses in respect of the London overhead charges, which, as I gathered from the case, are also included in this figure of £41,000. The case for the Crown can, I think, be put most forcibly in this way, that this particular sum of £78,000 odd is to be taken out of the trade altogether, and treated as if it had never been there at all. It can be put out of the computation and along with it the cost of earning it should also be excluded, and in that way the trade from both points of view would be considered as if there never had been any such profits at all. But I cannot find in the Act anywhere any provision which would justify any such elimination of a part of the expenses, where, as here, there is only one indivisible trade. It is quite different, as I say, from the cases to which I have referred which counsel for the appellant has cited. There is only one trade and we know exactly what are the expenses of that trade, and rule 3 (a) of the Rules applicable to Cases I and II of Schedule D provide that the expenses of the trade, if the "money is wholly and exclusively laid out for the purposes of the trade" are to be deducted. The result seems to be that the Legislature in the Income Tax Acts has expressly provided for certain exemptions and exclusion which will operate when the profits of the trade are being dealt with under Case I of Schedule D, and has, either inadvertently or by design, omitted to make any corresponding provision in respect of any allocation or apportionment of the expenses of the trade. In other words, when, for the purpose of taxation under Schedule D, Case I, you come to compute the profits, you have to exclude altogether this £ 78,000, because there is, according to the view which the Court here takes, express exclusion of these profits, and that reduces one side of the computation, but when you come to the other task of ascertaining the expenses "wholly and exclusively laid out for the purposes of the trade", you are faced with the total sum, and there is no provision for any apportionment. It may well be that that has followed from the circumstance that

these exemptions were introduced at a comparatively late date, and the effect of them was not considered in connection with rule 3. I do not know how that may be, but the short result is that I find no means, consistent with the language of the Act, of giving effect to this contention of the Crown. I think that some such provision ought reasonably to have been included in the Act, but I simply cannot find it. I have not gone through the various complications which may arise in regard to assessing the profits under Case I of Schedule D. I am quite content here to limit myself to the particular problem with which the Court is faced and to state the conclusion at which I have arrived.

The result on the whole case is that, in my judgment, the appeal fails and ought to be dismissed with costs.

ROMER, L.J.—The Master of the Rolls has dealt so fully with the facts and the law of this case that I have very little to add. In the few observations I shall make I propose to deal with the four questions arising upon the appeal in the order in which they have already been dealt with by the Master of the Rolls.

In making my observations on the first of those questions, I would like to begin by a reference to the case of *Liverpool, London and Globe Insurance Co. v. Bennett*, because that authority, in my opinion, has a very direct bearing upon the first question. In that case the Court was confronted with the application made by an insurance company resident and trading here amongst whose assets were included certain foreign securities such as are dealt with by Case IV of Schedule D of the Income Tax Act. The company, however, had not received in the year of assessment any interest from those securities; the interest had been allowed to accumulate abroad, and, that being so, under the Rules of Case IV of Schedule D, as they then stood, the company was not liable to direct assessment in respect of any of that interest. In those circumstances the company sought to have excluded from a statement of its profits and gains in its business the interest on those securities which had accrued to it abroad but had not been sent into this country, and they sought to have it excluded on the ground that inasmuch as they were not liable to be charged under that case, Case IV, in respect of that interest, so, too, they were not liable to be charged in respect of that interest under Case I.

Now, if the argument of counsel for the appellant on the first point is to be accepted, one would have thought that the Court would have disposed of the application of the insurance company in a very short way. They would have said: "Case IV of

Schedule D is dealing with interest. Case I of Schedule D is dealing with profits and gains of a trade—trading receipts; what have we got to do with interest?" That is not the view they took. They dissected the trading receipts; they discovered that among the trading receipts were those items of interest and they pointed out that those items of interest were dealt with by the two cases, both by Case I and by Case IV, and that the Crown had an option to share that interest either under Case IV, as it could, or under Case I.

Now, it is perfectly plain, I think, from that case that if the rules of Case IV had in terms excluded all such interest from all taxation, that interest would equally have been excluded from taxation as a trading receipt under Case I. It would not have been possible for the Crown to say: "It is true it is excluded under Case IV, but we claim that we have the right to tax it as a trading receipt under Case I." But the interest was not exempted from taxation by any of the rules of Case IV: it merely did not fall to be charged under Case IV because it did not happen to have been received in this country.

Now, applying that decision to the present one, Section 46 of the Act of 1918 says that the interest on War Loan shall not be taxed—as read the section—under any Schedule, and in my opinion it is impossible for the Crown to say: "It is indeed exempted from taxation but only from taxation as interest and we can charge it as a trading receipt under Case I." I think they are precluded from raising that point by the very decision in the *Liverpool, London and Globe Case*. But apart altogether from authority it appears to me that the words of Section 46 are quite plain and that interest on the War Loan is for all purposes of income tax exempt—in the case, of course, of the non-resident. So much for the first point.

The second point arises under Schedule C, rule 2 (d), in relation to interest on some India Stock and without any question at all that interest is dealt with in rule 2 of the Rules applicable to Schedule C. It is within this description: "Interest on dividends on any securities of a foreign State or a British Possession which are payable in the United Kingdom, where it is proved . . . that the person owning the securities and entitled to the interest or dividends is not resident in the United Kingdom". Now, it is said on behalf of the Crown that the rule must be read as though it said: "No tax under this Schedule shall be chargeable". The rule in terms says that no tax shall be chargeable in respect of,

amongst other things, the interest described in sub-rule (d). In my opinion there is no justification for so qualifying the word "tax". In rule 1 we find this: "Tax under this Schedule". In rule 3 we find the expression "tax under this Schedule". Rule 2, in contradistinction to those two rules, says: "No tax shall be chargeable". I should have been surprised to find that in clause 2 this particular kind of interest was only excluded from taxation under Schedule C because, as has been pointed out by the Master of the Rolls, before the Act of 1918 such interest was excluded from taxation under any and every Schedule by reason of the provisions of Section 71 of the Finance (1909-10) Act, 1910, and, to say the least of it, it is extremely unlikely that when passing the consolidated statute of 1918 and introducing, as it has been introduced by a rule to Schedule C, the provisions of Section 71, the Legislature intended those provisions to have a more restricted operation than they had before.

I now pass to the third question which, I agree, is rather more difficult. That question relates to interest on certain securities in a Canadian company and a New Zealand company respectively. That interest, again, is undoubtedly dealt with by rule 7 of the Miscellaneous Rules applicable to Schedule D. That rule provides as follows: (1) "Where any interest, dividends, or other annual payments payable out of or in respect of the stocks, funds, shares or securities of any foreign or colonial company, society, adventure, or concern . . . are entrusted to any person in the United Kingdom", and so on: "the same shall be assessed and charged to tax under this Schedule by the Special Commissioners". Then follows paragraph 2: "All the provisions of Schedule C relating to the tax to be assessed and charged in respect of dividends payable out of any public revenue other than that of the United Kingdom, and intrusted to any person"—I leave out immaterial words—"for payment to any persons in the United Kingdom shall extend to the tax to be assessed and charged under this rule." It will be observed that the sub-section does not say: "All the provisions of Schedule C relating to the assessment and charging of the tax" but that all the provisions of Schedule C relating to the tax are to apply.

I turn back once more to rule 2 of Schedule C—rule 2 (d). I have already expressed my opinion that that rule provides for complete exemption from taxation of the interest to which it refers. That being so, inasmuch as it is a rule relating to tax under Schedule C, it is one of the provisions which apply to the

tax that is to be assessed and charged under rule 7 of the Miscellaneous Rules applicable to Schedule B.

It is said by counsel for the appellant that before the Act of 1918 came into operation such interest was not exempt in such a case at all because Section 71 of the Finance (1909-10) Act, 1910, for some reasons or other, did not extend to interest from securities of Colonial companies. That is true. But why interest from Colonial companies should be placed in this respect on a different footing from interest from securities of foreign States I do not know, and I cannot help thinking that the omission of such interest from Section 71 of the Finance (1909-10) Act, 1910, was an oversight, and an oversight that was put right and was intended to be put right by the Act of 1918. I have no more to say about that question.

I now come to the fourth question, which is, I think, the most difficult of them all. Two alternative views may be taken on that question, views which I think I can best explain by an illustration. Suppose that a company—a non-resident company trading here—has in a particular year trading receipts amounting to £ 3,000, consisting of £ 1,000 from War Loan and £ 2,000 from other sources, and supposing that its trading expenses, properly chargeable under Schedule B, Case I, amount in the year to £ 600 the balance of profits and gains is £ 2,400. On that sum the Crown would be entitled to levy tax, but it will be observed that of that £ 2,400, £ 1,600 may be said to come from sources of revenue other than the interest of War Loan and £ 800 from interest of War Loan, and when the Crown seeks to lay its hand on the £ 800 for the purpose of taxing it, the tax-payer may say: "No. Section 46 forbids that; therefore you can only tax me on £ 1,600." In other words, the result of Section 46 would be to remove from the company's profit and loss account not the whole £ 1,000 interest on War Loan, but the £ 1,000 less its proper proportion of the trading expenses of the company. That is one way of looking at it. The other way of looking at it involves the application of Section 46 at an earlier stage. The application takes place in this way and at this time. When the company is drawing up its profit and loss account, or somebody is drawing it up on its behalf, the moment that amongst the trading receipts is put down this £ 1,000 the company says: "No, that must be removed from the account altogether having regard to Section 46 because by reason of Section 46 we are, for income tax purposes, to be treated as being in exactly the same position as though the War

Loan, which we have, produced no income at all." The result of that would be, of course, in the illustration I have given, that a company would be taxed under Case I merely on £ 1,400.

Now, I confess that the first of those two alternative views possesses for me a certain attraction. On the other hand, the Master of the Rolls—and GREENE, L.J., I understand, agrees with him—has taken the view that the second of those alternatives is to be preferred. I am not so enamoured of the first alternative as to differ from them.

In the circumstances I agree with the Master of the Rolls that this appeal fails on all four points.

GREENE, L.J.—I agree. It is no disparagement to the ingenuity with which the argument for the Crown has been presented to say that to my mind at any rate it is on all four points completely unconvincing.

I will say a few words of my own with regard to each of the four points which have arisen.

With regard to the first point, the question arises in this way: Section 46 of the Income-tax Act, 1918, provides that the interest of certain securities shall be exempt from tax and super-tax. The securities in question are securities which have been issued with a particular condition annexed to them, that condition being "that the interest thereon shall not be liable to tax or super-tax, so long as it is shown, in manner directed by the Treasury, that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom". Now, speaking for myself, I find in that language a perfectly clear legislative provision that, so long as the securities are in the beneficial ownership indicated in the section, no tax is to be levied in respect of the interest upon them. To say, as has been said on behalf of the Crown, that the true effect of the section is merely that the interest is not to be taxed as interest but can be taxed as part of an aggregate of profits of trade, appears to me to override the perfectly plain language of the section. It is a matter of some satisfaction that the construction which I consider should be placed upon the section will enable the perfectly clear undertaking given in the prospectus when this War Loan was issued to the public to be kept both in the spirit and in the letter.

The second point arises under Schedule C, rule 2. The subject-matter with which it is concerned is interest on securities of a British possession, and rule 2 of Schedule C provides that no tax shall be chargeable in respect of that interest in the case of non-residents.

Now, it is to be observed that this particular interest has its proper home in Schedule C. Schedule C in the Schedule to which, in the first instance, it is quite plainly appropriate, and it is by that Schedule that this class of interest is in fact taxed. Now, when I find that the Schedule to which a class of income is appropriate and in which it is dealt with says, in terms, that no tax shall be chargeable in respect of that income in certain circumstances, I myself find it quite impossible to read those words as meaning simply "no tax shall be chargeable under this Schedule." The fact that the income is by its nature income to which that Schedule is applicable in the first instance makes it impossible to my mind to read the words "no tax shall be chargeable" with any such qualification upon them. When the Legislature wishes to show that an exemption in a Schedule is to be limited to the tax chargeable under that Schedule, it does so in plain terms, as indeed it has done in rule 3 of Schedule C. In my opinion the second point also fails.

The third point arises in this way. By rule 7 of the Miscellaneous Rules to Schedule D: "All the provisions of Schedule C relating to the tax to be assessed and charged in respect of dividends payable out of any public revenue other than that of the United Kingdom" are to apply to what, for convenience, I will shortly call the dividends of foreign companies. I agree that it is sufficient to conclude this matter to observe that the language of paragraph 2 of rule 7 is, as my brother Romer has pointed out, to this effect, that all the provisions of Schedule C relating to the tax to be assessed and charged are to apply, and when I turn back to Schedule C and see what are the provisions relating to the tax to be assessed and charged, one of them is unquestionably rule 2. In addition to the matter of exemption which is provided for there, it is worth calling attention to this circumstance, that one of the provisions of that rule in Schedule C in relation to the tax is that which provides for the manner in which the exemption is to be given effect to, namely, by allowance or repayment on a claim being made to the Commissioners of Inland Revenue. For my part it appears to me that the language of rule 2, taken by itself, is quite sufficient to decide the question, but if the matter be examined a little further this conclusion is, I think, confirmed.

Counsel for the appellant contended that the only effect of paragraph 2 of rule 7 was to import a particular set of provisions relating to assessments which are headed in Schedule C, "Rules as to Interest, etc., with the payment of which

persons other than the Bank of England, the Bank of Ireland and the National Debt Commissioners are intrusted". He then went on to say that under the second of those rules the Special Commissioners, when they are busying themselves with the assessment of the paying agents, can and indeed, if they have sufficient information, should exempt from the charge any dividends payable to what, for convenience, I call a non-resident, and should do that not by virtue of any express exemption collected from Schedule C but because by Schedule D itself the tax is limited to non-residents.

I have not myself heard it explained with regard to that last point why it is that the words should not be sufficient to bring under charge to tax dividends payable to non-residents, in view of sub-paragraph (b) of paragraph 1 of Schedule D, in which there is no mention of residence at all, and Case VI. However that may be, the result will work out, according to counsel's argument, in this way, as I understand it. The Special Commissioners are assessing the paying agents. They will not—and it is common ground that they will not—in probably the majority of cases have before them the information as to the ownership of the securities which would enable them to give effect to any exemption which an owner is entitled on the ground that he was a non-resident. They will, therefore, assess the paying agent in respect of the amount which he is to pay over to the owner of the shares.

Now, what is to happen? According to counsel's argument, the remedy of the taxpayer who is aggrieved by that decision is not a remedy which is governed by Schedule C at all but it is a remedy based on the fact that he has been improperly assessed to tax or, rather, his dividend has been improperly assessed to tax because under Schedule D it ought never to have been assessed at all. Now mark what would happen. His right would apparently be to obtain repayment by a petition of right and the issue of residence or non-residence would be an issue of fact to be decided by the Court. Unless and until he has recovered his tax it would be quite impossible for the Crown, while the assessment of the paying bank in respect of that dividend stands, to raise a fresh assessment against the shareholder under Case I, because there would then be standing at one and the same time in respect of one and the same piece of income two assessments. The way it will work out, according to counsel's argument, in practice would be this, that the assessment under Case I of the non-resident proprietor, who has obtained repayment, either because the Commissioners are

satisfied without litigation or as the result of litigation, would then fall to be revised, in order to bring into it an item of income which obviously could not have been brought into that assessment before because it had already been taxed. That would still leave this curious position, that there would still be on foot in respect of the same piece of income two assessments, because the effect of repayment to the proprietor of the tax deducted from his dividend would not be to revise or displace the original assessment, and there would be the anomalous position, as I say, of two existing assessments standing in respect of the same piece of income.

I, for my part, find it impossible to suppose that that is a result which the Legislature was contemplating. Whether or not the previous legislation had the effect of importing rule 2 (d) of Schedule C by reference into the provisions of rule 7 of the Miscellaneous Rules applicable to Schedule D I do not find it necessary to determine. In my judgment that rule is quite clearly imported by the Consolidation Act of 1918, and if that be the case, the way the machinery will work will be this: The assessment having been made upon the paying agent, the non-resident proprietor can avail himself of the machinery provided in rule 2 (d) of Schedule C, by proving to the satisfaction of the Commissioners of Inland Revenue the fact of his non-residence and then obtaining relief by way of allowance or repayment. That that is what the Legislature intended is, in my opinion, made quite clear when the Finance Act, 1924, is examined. Under Section 27 of that Act a new right of appeal to the Special Commissioners was given from a decision of the Commissioners of Inland Revenue. It is to be observed that the right is a right to appeal from a decision. When the decisions with which the section deals are examined, omitting for the moment the one relevant to this point, it will be found that each and every one of them is a decision of the Commissioners of Inland Revenue under a statutory power given to them in the Act to decide the issue of fact, residence or non-residence, domicile or non-domicile, as the case may be. Therefore, it appears to me extremely unlikely that in such a context there will be found a right of appeal given—as counsel would have us construe the paragraph to which I am about to refer—not from a decision of the Commissioners given in the exercise of a statutory jurisdiction to decide a matter of fact but from some administrative refusal to repay tax which has been improperly levied.

I myself find it quite impossible to read the section in that way. The section is dealing with decision and decision means

prima facie a decision of an express character under some power to decide, and that power is found in each of the other cases.

The case in question here gives a right of appeal from a decision of the Commissioners with regard to any questions as to residence arising, firstly, under paragraph (d) of rule 2 of the General Rules applicable to Schedule C or, secondly, under rule 7 of the Miscellaneous Rules applicable to Schedule D in connection with a claim for repayment of income-tax made to the Commissioners of Inland Revenue by the person owing the stock, etc., from whose income a deduction has been made on account of the income-tax assessed and charged under the rule. That language shows, to my mind, as clearly as anything can show that the procedure to which reference is being made, and in respect of which a right of appeal is being given, is a procedure in which, tax having been assessed on and paid by the paying agent, the owner of the share then makes, to the Commissioners of Inland Revenue, a claim for repayment, on which claim the Commissioners of Inland Revenue have under the existing legislation a power to give a decision, and it is from that decision that the right of appeal to the Special Commissioners is granted.

Now that exactly fits the language of rule 2, paragraph (d) of Schedule C because under that rule the obligation of the shareholder who seeks repayment is to prove the fact of non-residence to the satisfaction of the Commissioners of Inland Revenue, in other words, they are the people who have the statutory power to decide that matter of fact. The manner in which the exemption is given effect to under that rule is by way of repayment of tax, words which appear again in Section 27 (3) (c) of the Act of 1924. Indeed, when the language is appreciated the whole matter to my mind fits together, both from the point of view of substance and from the point of view of machinery. It is worth observing that when the Legislature by Section 10 of the Income-tax Act, 1853, extended to this class of dividend the machinery which had previously been applicable to the case of interest of foreign or Colonial Government loans, it was bound to bring it into charge under Schedule D, because the language of Schedule C which is confined to interest payable out of public revenue would not have been apt to cover it, and if it was to have been brought under Schedule C, Schedule C would have had to be amended for that purpose. Schedule D was the appropriate Schedule in which to put it, but the Legislature, having regard to the close correspondence between the circumstances of the two cases, when they brought it into

Schedule D made it subject to the provisions of Schedule C with regard to the matters appropriate to Schedule C and that, to my mind, is the history of the matter. Whether or not before the Act of 1918 there was some gap in that correspondence is beside the point. In my opinion the correspondence, if it was not perfect before, was made perfect by the Act of 1918.

That brings me to the last point, the question of expenses. The argument for the Crown on that point is of this nature, that in the account of a trading company made out for the purpose of its return under Case I of Schedule D the interest with which we are concerned must, in the first instance, be brought into the account of an item of receipt; and that the statutory provisions which exempt the interest from tax are to be given effect to by then removing altogether that item from the statement of profits and gains, and removing with it something which clings to it in the process of removal, namely, some apportioned part of the expenses of the company. Now I can find no warrant whatever in the language of the statute to produce that result. When the statute says that interest is to be exempt I am quite unable to read it as meaning that in giving effect to that exemption by implication some repercussion is to take place on a different provision of the Act altogether. It seems to me quite improper to read any such implication into it. Counsel for the appellant says, and says with truth, that there are many cases in the working of the Act where it is necessary to make apportionments, and he instances as one the case where a non-resident company carries on business both in England and abroad and its accounts have to be dissected in order to bring in only that part of the business which is appropriate for the purposes of taxation. That is perfectly true, and the reason why the dissection has to be made there is that the statute quite clearly requires it and cannot be effective unless it is made. But in this case I can find nothing in the statute which requires this interest to be treated, so to speak, as a trade within a trade. This is really what the Crown contends, that in some way this interest which is to be brought into the account as an item of receipt is to be taken out of it with some apportioned expenses appropriated to it as though it were a trade by itself. If the Legislature had intended that, in my opinion, it should have said so, and I am quite unable to construe the language of the relevant exemption clauses—because the suggested result can only arise from an implication from those clauses or a qualification upon them—in the way contended for.

I agree that the appeal fails on all points and should be dismissed with costs.

Appeal dismissed.

Solicitors—*Solicitor of Inland Revenue*, for the Appellant.

Linklaters & Paines, for the Respondent.

[IN THE LAHORE HIGH COURT].

RAJ MAL-PAHAR CHAND

v.

COMMISSIONER OF INCOME-TAX, PUNJAB.

SIR JAMES ADDISON, A. C. J., and DIN MUHAMMAD, J.

June 24, 1938.

BAD DEBTS—CLAIM FOR BAD DEBT—CLAIM REJECTED ON THE GROUND THAT DEBT HAD NOT BECOME BAD—ASSESSMENT FOR SUBSEQUENT YEAR—INCOME-TAX OFFICER DISAGREEING WITH HIS PREDECESSOR AND HOLDING THAT DEBT HAD BECOME BAD LONG AGO—FINALITY OF LATER DECISION.

In the assessment for the year 1934-35 the assessee claimed deduction of certain debts as bad debts. The Income-tax Officer disallowed the claim on the ground that the debts had not yet become bad and the claim was therefore premature. The assessee appealed but withdrew the appeal accepting the Income-tax Officer's decision and reserving his claim for the next assessment. In the assessment for 1935-36 the assessee pressed his claim but the then Income-tax Officer held that the debts had become bad in 1932-33 and rejected the claim and his decision was upheld on appeal. On a reference made by the Commissioner as directed by the High Court: Held that there was material upon which the conclusion arrived at by the Income-tax authorities in the year 1935-36 could be based and their decision was final. [The Commissioner, however, offered to move the Central Board of Revenue for permitting him to revise the 1934-35 assessment under Section 104 (1) of the Income-tax Manual].

Case referred under Section 66 (3) of the Indian Income-tax Act by K. C. Basak, Esq., Commissioner of Income-tax, Punjab, N.W.F. and Delhi Provinces, Lahore dated the 22nd April 1938, for orders of the High Court in the matter of the assessment of

income-tax on Messrs. Raj Mal-Pahar Chand of Amritsar, for the year 1935-36. Civil Reference No. 6 of 1938.

STATEMENT OF CASE.

The sources of income are property, piece-goods business and share in an unregistered firm. Assessment for 1934-35 was made in the status of a registered firm. In the assessment for 1934-35 the assessee claimed two bad debts of Rs. 7,128 and Rs. 2,684 in two accounts styled "Relu Mal-Dharam Chand" and "Relu Mal-Gurmukh Das". That year the Income-tax Officer disallowed the claim in respect of both the items holding it to be premature and remarking that the claim would be considered on its merits next year. Assessment order for 1934-35 is exhibit A. The assessee filed an appeal before the Assistant Commissioner in which one of the grounds was directed against the disallowance of the two items. On the date of hearing of the appeal the assessee, however, withdrew this ground in writing at the end of the grounds of appeal in the following terms: "Having been held premature these two items are withdrawn for the present for the settlement during next assessment as also remarked by the learned Income-tax Officer".

Copy of the grounds of appeal with the above endorsement of the assessee is Exhibit B. Accordingly this ground was not discussed by the Assistant Commissioner in the appellate order. Assessment for 1935-36 was made in the status of Hindu undivided family instead of a registered firm and in Civil Miscellaneous No. 352 of 1397 this change in the status has been upheld by their Lordships. In the assessment for 1935-36 the assessee again claimed the two items of bad debts Rs. 7,128 and Rs. 2,684 in the accounts of Relumal-Dharamchand and Relumal Gurmukhdas, but the Income-tax Officer (now another gentleman) who made the assessment for 1935-36 disallowed the claim on the ground that the amounts had become irrecoverable long ago, namely, in 1932-33, and therefore they were not admissible deductions against the income of the year under assessment. The accounting period in question is the year ending *Chet* V, 15, 1991. Assessment order for 1935-36 is Exhibit C. The assessee preferred an appeal. The relevant ground is Exhibit D. The Assistant Commissioner upheld the action of the Income-tax Officer. The relevant portion of the appellate order is Exhibit E. Being dissatisfied with the decision of the Assistant Commissioner the assessee filed an application under Section 66 (2) before my predecessor. Copy of the application under Section 66 (2) with its

enclosures is Exhibit F. My predecessor refused to refer the case to the Hon'ble High Court. The relevant portion of his order is Exhibit G. It will appear from this order that my predecessor came to the finding that the amount in fact did fall bad in the period under 1934-35 assessment and that it did not fall bad in the period under 1935-36 assessment and conditionally on withdrawal of the claim of the assessee that the debts became bad in the period under 1935-36 assessment, my predecessor was prepared to abate the demand for 1935-36 by the amount of tax on the two disputed sums at the effective rate of taxation in the 1934-35 cases. He was not however prepared to intervene directly in the 1934-35 cases as they stood as that involved interference in three personal and one firm case out of the normal time for review. Not being satisfied with my predecessor's order the assessee filed an application (Exhibit H) under Section 66 (3) before the Hon'ble High Court.

2. **Question referred.**—As directed by their Lordships' order dated 9th December, 1937 (Exhibit I) in Civil Miscellaneous No. 351 of 1937, I refer the following question for the decision of their Lordships:—

“Was there any material on which the conclusion arrived at in the second year 1935-36, could be based in the circumstances mentioned above?”.

3. **Opinion of the Commissioner.**—I submit that the first point to be determined in this case is when the two items of debt really became bad. In Exhibit G my predecessor after considering all the materials came to the conclusion that the debt had become bad in the period under 1934-35 assessment. This was also the case of the assessee in the assessment for 1934-35. A wrong finding by the Income-tax Officer in the assessment for 1934-35 will not advance the date of badness of the debt when it had really become bad in the period under 1934-35 assessment, as found by my predecessor on facts and as was claimed by the assessee at the time of the assessment for 1934-35. In my opinion therefore the proper course is to allow the claim in the assessment for 1934-35 though it would involve the revision of the firm's assessment and individual assessment of the three partners. As the time limit for revising the assessment for 1934-35 under Section 33 had expired at the time of hearing before me, I offered to move the Central Board of Revenue for allowing me to revise the assessments for 1934-35 even now under the last sentence of paragraph 104 (i) of the Income Tax Manual, but Mr. Kirparam Bajaj, who

appeared for the assessee, was not agreeable to such a course. The assessee is obviously anxious to take advantage of the wrong decision of the Income-tax Officer in the assessment for 1934-35 and press the claim of bad debts against the assessment for 1935-36 as that would give him relief at a higher rate, seeing that he has failed to obtain relief in respect of the status in the assessment for 1935-36. If their Lordships do not dispute my predecessor's finding on facts that the debts became bad in the period under 1934-35 assessment, then I would submit that the answer to the question formulated is that the assessee is not entitled to claim deduction on account of the debts in the assessment for 1935-36.

Kirpa Ram, for the Petitioner.

J. N. Aggarwal, for the Respondent.

ORDER.

After hearing counsel we are of opinion that the reply to the question must be in the affirmative and this makes the decision of the income-tax authorities final. We are glad, however, to note that the Commissioner was willing to move the Central Board of Revenue to allow him to revise the assessments for 1934-35 even now and we have no doubt that he will still do so in the special circumstances of this case. Parties will bear their own costs of this reference.

[IN THE NAGPUR HIGH COURT].

ANWARKHAN MAHBOOBKHAN & CO.

v.

COMMISSIONER OF INCOME TAX, CENTRAL PROVINCES, BERAH & U. P.

NIYOGI and GRUBE, JJ.

July 13, 1938.

REFERENCE—BEST JUDGMENT ASSESSMENT—APPEAL FROM APPLICATION TO CANCEL ASSESSMENT—QUESTIONS RELATING TO VALIDITY OF ASSESSMENT ON THE MERITS CANNOT BE REFERRED—INDIAN INCOME-TAX ACT (XI OF 1922), SECTIONS 23 (4), 27, 66 (3).

In an appeal from an order under Section 27 of the Income tax Act refusing to cancel an assessment under Section 23 (4), the question whether the assessment was valid or justifiable on the merits does not arise and the Commissioner cannot be required to

state a case on questions of law relating to the merits of the assessment. If the assessee wishes to contest the assessment on the merits he should prefer an appeal from the order of assessment itself.

Application under Section 66 (3) of the Income-tax Act praying for an order requiring the Commissioner of Income-tax, C.P. and Berar, to state the case of the assessee Messrs Anwarkhan of Jubbulpore in Reference Case No. 5 of 1934-35.

Miscellaneous Judicial Case No. 10 of 1935.

ORDER.

This is an application under Section 66 (3) of the Income-tax Act asking for a requisition to be sent to the Commissioner of Income-tax to state the case and refer it to the High Court for its opinion.

2. The applicants are Bidi manufacturers who carry on their business under the name and style of Anwarkhan Mahboobkhan & Co., at Jubbulpore. For the assessment year 1931-32 they were assessed on a total income of Rs. 34,417 on the basis of closed accounts on 10th October 1931. During the progress of the assessment proceedings for the year 1932-33 it was discovered that quite a substantial part of the income assessable for 1931-32 had escaped assessment. The Income-tax Officer therefore took action under Section 34 and served notice on the applicant company under Section 22 (2) and (4) of the Income-tax Act calling upon them to submit a return of their income for the year 1931-32 and also to produce their account books for the years 1935-36 and 1936-37. They did not submit the return of their income as required, pleading that no income had escaped assessment, and also failed to produce the account books on the excuse that they had been lost. On evidence it was found by the Income-tax Officer that the story of the loss of the account books was false and he therefore made an assessment for the year 1931-32 on a total income of Rs. 85,327 (as against Rs. 34,417 assessed originally) under Section 23 (4) of the Income-tax Act. That order was passed on 16-8-33 and a notice of demand was served on the applicant on 23-8-33.

3. The applicants had two alternative remedies, either to prefer an appeal to the Assistant Commissioner against the fresh assessment under Section 23 (4) or, if they did not want to challenge the order on its merits, to make an application under Section 27 of the Income-tax Act to the Income-tax Officer to cancel the assessment and proceed to make a fresh assessment on

the ground that they were prevented by sufficient cause from complying with the notice to make the return of income or to produce the necessary documents. The applicant chose the latter course and made an application under Section 27 of that Act to the Income-tax Officer on 5-9-33. In that application the applicants sought to raise objections to the correctness of the assessment made under Section 23 (4) on 16-8-33, but their objections were not entertained by the Income-tax Officer as will be clear from the following remarks in his order dated 16-12-33. "The assessee had drawn my attention to the order dated 10-10-31 in his case for 1931-32 which was passed after examination of accounts and has urged that it was based on facts while the *ex parte* order that is being contested is said to be based on mere suspicion and presumption. The provisions of Section 27 do not, however, provide for a discussion on the merits of an *ex parte* order but are restricted to a discussion on the sufficiency of cause for the default". He on enquiry, dismissed that application. Thereon the applicants preferred an appeal to the Assistant Commissioner on 18-1-34 on Form A which is the prescribed form of appeal against an order refusing to re-open an assessment under Section 27. In that appeal also they sought to contest the correctness of the assessment made under Section 23 (4) but the Assistant Commissioner, as is clear from paragraph 8 of his order dated 29-3-34, declined to go into the merits of the assessment saying that he was precluded from considering it on the merits. As a matter of fact the applicants argued only two points before him, (1) that there was no default under Section 22 (2) in making a return of their income, and (2) that they were not in possession of the required account books. These contentions were elaborately considered but were overruled. The applicants thereafter submitted to the Commissioner of Income-tax a combined petition under Sections 33 and 66 (2) of the Income-tax Act wherein they contested the findings on issues which fell within the purview of their application under Section 27 as also the correctness of the assessment made under Section 23 (4) of the Income-tax Act and they asked the Income-tax Commissioner to refer the case to the High Court on 10 questions of law which are embodied in appendix A attached to the application made to this court under Section 66 (3) of the Income-tax Act. The Commissioner held that questions 2 to 5 did not arise out of the appellate order under Section 31 as they fell outside the pale of Section 27 of that Act which only concerns the sufficiency of reasons bringing about the

default. He therefore refused to state the case on those points and declined to refer them to the High Court. As to the questions 1, 6, 7, 8, 9 and 10 he observed that they concerned the procedure adopted by the Income-tax Officer and involved questions of fact pure and simple. He however in exercise of his power under Section 33 of the Act allowed the assessee Rs. 6,706 out of the court expenses which had been disallowed.

4. Upon the application made in this court under Section 66 (3) of the Income-tax Act it is urged that the points embodied in Appendix B of the application are questions of law on which the Income-tax Commissioner should be directed by this court to state the case and refer it to this court.

5. We have carefully listened to the arguments addressed at some length on behalf of the applicants, but we see no ground to dissent from the Income-tax Commissioner that the case does not involve any questions of law to justify a reference to the High Court.

6. The points raised in Appendix B are no doubt points of law but they do not arise out of the application made by the applicants under Section 27 of the Income-tax Act. They no doubt endeavoured to get a decision on those points from the Income-tax Officer, the Assistant Commissioner, and the Commissioner, but all these officers declined to entertain them as they did not and could not arise on the application made under Section 27 of the Income Tax Act. The applicants ought to have preferred an appeal against the Income-tax Officer's order dated 16-8-33 which they failed to do within 30 days of the receipt of the notice of demand relating to the assessment made on 10-8-33. It is urged that although they failed to prefer such an appeal it was open to the Assistant Commissioner to treat the appeal filed on 18-1-34 as one made against the assessment under Section 23 (4) as well. It was no doubt open to the Assistant Commissioner to condone the delay and admit an appeal after expiration of the period of limitation if he was satisfied that the applicants had sufficient cause for not presenting their appeal within the period of 30 days, but no such sufficient cause was shown by the applicants, nor did the Assistant Commissioner condone the delay. On the other hand he made it perfectly clear in his order dated 16-12-33 that he would not go into the merits of the assessment made under Section 23 (4). The fact that he expressed some opinion incidentally about the points raised regarding that assessment cannot mean that the Assistant Commissioner treated the appeal before him as one made against

the merits of the revised assessment. The Commissioner also excluded these questions from his consideration and if he interfered with the assessment to a limited extent it was done under the special power vested in him by Section 33 to correct a manifest error.

7. Since these questions did not arise on the application made under Section 27 of the Income-tax Act, the Commissioner was right in declining to refer them to this Court. Reliance is placed on *Duni Chand v. The Commissioner of Income-tax*, I.L.R. 9 Lah. 464; *Khushi Ram v. Commissioner of Income-tax, Punjab* A.I.R. 1927 Lah. 288; and *The Commissioner of Income-tax, Burma v. Dey Brothers* I.L.R. 14 Rang. 228 and it is urged that the Assistant Commissioner having considered however partially these questions, and the Commissioner having in fact interfered with the revised assessment, it should be held that these questions of law fell within the purview of the appeal to the Assistant Commissioner and the application to the Commissioner. We do not see our way to assent to this convention in view of the fact that both the officers declined to entertain these questions on the ground that they were foreign to the issue which was actually before them. It is pertinent to notice that in each of the cases relied on by the learned counsel for the applicants, there was an appeal to the Assistant Commissioner against the correctness of the revised assessment. In this case there was no appeal preferred against the revised assessment, and the Assistant Commissioner and the Commissioner were right in not permitting the applicants to import these questions in an appeal to which they were not germane.

8. We see no substance in this application and dismiss it with costs. Counsel's fees Rs. 50.

[IN THE BOMBAY HIGH COURT].

COMMISSIONER OF INCOME-TAX, BOMBAY

v.

GOVINDRAM SEKSARIA.

SIR JOHN BEAUMONT, C.J., and BLACKWELL, J.

March 25, 1937.

INCOME—PLACE OF ACCRUAL—FOREIGN EXCHANGE BUSINESS
—ASSEESSE INSTRUCTING BROKER IN BOMBAY FOR SALE AND PUR-
CHASE OF COTTON AT NEW YORK—BOMBAY BROKER PLACING

ORDERS WITH NEW YORK FIRM—NO PRIVACY OF CONTRACT BETWEEN ASSESSEE AND NEW YORK FIRM—PROFITS, WHETHER ACCRUE AT BOMBAY OR NEW YORK—ASSESSABILITY—INDIAN INCOME-TAX ACT (XI of 1922), Sec. 4 (1).

The assesseees were a firm trading in Bombay as brokers and in cotton and other commodities. They instructed another firm of brokers S.P. & Co., who also carried on business in Bombay, to enter into transactions for them on the New York Exchange for the buying and selling of cotton. S. P. & Co. placed orders with brokers in New York for the purchase of cotton for the assesseees and other persons and also gave instructions to sell the cotton. The profits were payable to the assesseees at Bombay by S. P. & Co. and similarly if the transactions resulted in loss the loss was payable by the assesseees to S. P. & Co. at Bombay. It was found by the Commissioner that there was no privity of contract between the assesseees and the brokers of New York and that S. P. & Co. were alone responsible to the assesseees. In the year of assessment (1934-35) there was a profit of 29,000 dollars and 8,500 dollars respectively on two transactions. These amounts were entered in the account of S. P. & Co. as paid in cash to the assesseees through the National City Bank of New York and were allowed by the assesseees to remain in New York :

Held, distinguishing CHUNILAL MEHTA'S CASE (1935 I.T.R. 376) that on the findings of the Commissioner the assesseees' profits were derived from contract and as the contract was made in Bombay (whether or not the moneys were to be paid in Bombay) and resulted in profits, these profits accrued or arose within British India within the meaning of Sec. 4 (1) of the Indian Income Tax Act.

Commissioner of Income Tax, Bombay v. Chunilal Mehta [1935] (1935 I.T.R. 376 ; 37 Bom. L.R. 753) distinguished.

Case stated by the Commissioner of Income Tax, Bombay, under Sec. 66 (2) of the Indian Income Tax Act (XI of 1922) : Civil Reference No. 13 of 1936.

STATEMENT OF CASE.

" Under Section 66 (2) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as the "Act"), and the instance of Messrs. Govindram Seksaria (hereinafter referred as the "assesseees"), I have the honour to refer to your Lordships for favour of decision the questions of law set out in paragraph 13 below which

have arisen out of the income-tax assessment of the assessee for the financial year 1934-35 ended on 31st March 1935.

2. **Facts of the Case.**—The assessees who are a registered firm have been trading in Bombay for several years past as brokers and speculators in cotton, silver and other commodities. They have an office in Bombay and have besides income from properties, dividends, interest on securities, etc. As regards their speculation business, the assessees do this on their own account as well as on account of their constituents and they do it either direct or through other brokers.

3. For the purpose of their assessment for the financial year 1934-35, ended on 31st March 1935, the assessee put in a return of income under Section 22 (2) of the Act declaring therein a total income of Rs. 6,41,121. On receipt of this return of income, the Income-tax Officer called for accounts under Section 23 of the Act and on examining them found that the assessees had not accounted for two sums of 29,043 dollars and 8,500 dollars equivalent respectively to Rs. 81,000 and Rs. 25,376 making together the sum of Rs. 1,06,406 being profits earned on certain speculative business done through the firm of Messrs. Sarupchand Prithiraj carrying on business *in Bombay* as brokers and speculators and credited in the latter's books to the account of the assessees. The assessees stated that they did not declare this profit for taxation purposes as it was on account of business done at New York through the above firm of brokers and as it was not actually received in British India. The Income-tax Officer, however, was of opinion that the profit not only accrued and arose in British India but that it was also brought into and received in British India. He found that the assessees had entered into contracts *in Bombay* for the forward purchase or sale of cotton with the firm of Messrs. Sarupchand Prithiraj with the express stipulation that all profit earned was payable *in Bombay* to them by Messrs. Sarupchand Prithiraj and all losses incurred were to be paid to the latter by them (the assessee) *in Bombay* and that all suits regarding the transactions were to be instituted only *in Bombay*. He further found that the profit earned was in accordance with these conditions duly credited to assessees' account in the books of Messrs. Sarupchand Prithiraj who had thus placed it at their disposal and that the assessees actually operated upon the money by withdrawing in cash a part of it and ordered the rest to be invested in New York. He therefore included the said sum of Rs. 1,06,406 in the total income of the assessees and assessed them o income-tax accordingly. The

relevant extract from the assessment order dated 12th August 1934 pertaining to this item as well as the relevant extract from the assessment order for 1932-33 dated the 5th December 1933 and referred to therein are annexed hereto and collectively marked Exhibit A.

(4) Being dissatisfied with the above assessment, the assessees appealed under Section 30 of the Act to the Assistant Commissioner of Income-tax, A Division, Bombay, by their petition of appeal dated 18th September 1935 (a copy of which is annexed hereto and marked Exhibit B) objecting to the inclusion of the above two items of Rs. 81,030 and 25,376 totalling Rs. 1,06,406 in the income liable to tax and also setting forth several other objections against the assessment levied by the Income-tax Officer. The Assistant Commissioner, after hearing the contentions on behalf of the assessees, rejected the claim made as regards the said item of Rs. 1,06,406 for reasons recorded in his order dated 18th November 1935 an extract from which pertaining to this item as well as an extract from the 1932-33 appellate order referred to therein are annexed hereto and collectively marked Exhibit C.

(5) The assessees being dissatisfied with the order of the Assistant Commissioner, by their petition dated 10th January 1936 (a copy of which is annexed hereto and marked Exhibit D) applied to me asking me either to exercise my powers under Section 33 of the Act and grant their claim or refer the case to the Honourable Court under Section 66 (2) of the Act. After hearing the assessees and making further enquiries, being unable to grant any relief, I beg to submit this statement of the case for favour of Your Lordships' decision.

6. For the convenience of the Honourable Court, I have summarised in the following paragraphs particulars of the assessees' transactions which resulted in the above-mentioned profit of Rs. 1,06,406. They will show how this speculation business was actually carried on.

7. The assessee gave an *oral* order in Bombay to the above-named firm of brokers, viz, Messrs. Sarupchand Prithiraj in Bombay and the latter thereupon, on 15th May 1933, sent a telegraphic discretionary order to brokers A. Nordon & Co., New York, to buy at market rates 1,000 bales of American cotton for March delivery (a copy of the telegram is annexed hereto marked Exhibit E). Accordingly, the latter purchased the 1,000 bales on 25th May 1933 at 9'08 cents per lb. as will be seen from their reply telegram Exhibit E. A similar order for the purchase of another

1,000 bales was given by the assesseees to Messrs. Sarupchand Prithiraj and this was placed by the latter on 9th June 1933 with the brokers Messrs. Orvis Brothers of New York who executed the order for purchase on the same day at 9'54 cents per lb. (*vide* please copies of telegrams, Exhibits F and F1). The said telegrams, Exhibits F and F1, it will be noticed, really refer to the purchase of 2,400 bales consisting of 1,200 bales, March 1934 delivery, and 1,200 bales, May 1934 delivery and out of these, Messrs. Sarupchand Prithiraj allocated the purchase of a thousand bales, March delivery, to the assesseees. The contracts with the New York brokers to buy were between Messrs. Sarupchand Prithiraj and them and not the assesseees. Thereafter, on 17th July, the assesseees *orally* ordered Messrs. Sarupchand Prithiraj to sell the above 2,000 bales and the latter thereupon cabled an order to J.S. Bache & Co., New York, to sell these and several other bales. The latter replied that they had sold 1,000 March delivery bales at 12'30 cents, 1,900 March delivery bales at 12'29 cents and 400 January delivery bales at various other rates (*vide* copies of telegrams annexed hereto marked Exhibits G and G1). Out of the above sales of 2,900 bales March delivery, Messrs. Sarupchand Prithiraj allocated to the assessee a sale of 100 bales only at 12'30 cents together with the 1,900 bales sold at 12'29 cents. This is important as though as many as 1,000 bales were sold at 12'30 cents, Messrs. Sarupchand Prithiraj did not pass on the whole of that sale at the higher price of 12'30 cents to the assessee, the obvious reason being that it was not in fact the assesseees who were dealing with the New York brokers but Messrs. Sarupchand Prithiraj themselves, the sales in question being effected on their behalf by the said New York brokers. Messrs. Sarupchand Prithiraj themselves thus operated on the New York Market and sold certain bales on their own account and then disposed of the sales amongst their constituents here as seemed best to them, giving the assesseees the benefit, to the extent of 100 bales only, of the highest price realised. The net result of the transactions thus conducted by the assesseees with Messrs. Sarupchand Prithiraj was a profit of dollars 29,033.5 as worked out in the statement Exhibit H annexed hereto. This profit was paid by Messrs. Sarupchand Prithiraj to the assesseees in cash on 18th July 1933 as will be seen from the copy of the account of the assesseees in the books of Messrs. Sarupchand Prithiraj annexed hereto marked Exhibit I. Exhibit J is a copy of the corresponding journal entry which runs as under—

"Govindram Seksaria account. Dollars currency account paid through National City Bank of New York in dollars, being profit on 2,000 bales of American Cotton in New York for March 1934 delivery as per Statement No. 11067 dollars 29,048.5." In exactly the same manner, 4000 more bales were purchased on 16th August 1933 and sold on August 19th 1933, bringing in a profit of dollars 8,500,40. Copies of telegrams sent and received as well as extracts from the ledger and the journal and the statement of account pertaining to this transaction are annexed hereto marked Exhibits K, K1, L, L1, L2, I, M and N.

8. A consideration of the above transactions will show that there was, as already indicated, no privity of contract whatever between the assesseees and the New York brokers who recognised Messrs. Sarupchand Prithiraj only. It was the latter who purchased the bales from the New York brokers and passed them on to the assesseees. For all moneys due on account of these purchase contracts, Messrs. Sarupchand Prithiraj were alone responsible to A. Norden & Co., and to Orvis Brothers and not the assesseees.

9. Messrs. Sarupchand Prithiraj say that all orders to buy or sell were given to them *orally* by the assesseees and that owing to their very intimate connection with them, nothing in writing was ever taken. No documentary evidence, from which exact particulars as regards the orders given can be ascertained is therefore available. It is, however, alleged that it was the practice after the execution of the orders, to take confirmation of the transaction in a printed form from the party concerned. As regards the above transactions, however, no such confirmations are forthcoming, the reason advanced being that none were taken from the assesseees since Messrs. Sarupchand Prithiraj had full faith in them.

10. The above transactions were all mere forward, speculative transactions in which no delivery was ever taken or intended. In order that these contracts may be enforceable in Civil Courts, it is usual to note in the printed form of such contracts that actual delivery is contemplated. As a matter of fact, the transactions being all for future delivery, long before the date for delivery arrives, the contracts are disposed of. If the price realised is greater than the one paid, the party concerned gains; if it is less, he loses.

11. As far as the above transactions are concerned, it is an admitted fact that Messrs. Sarupchand Prithiraj of Bombay were responsible to the assesseees only and all profit earned was payable *in Bombay* by the latter to the assesseees. It is also admitted that

it was agreed that any dispute as regards the contracts entered into was to be adjudicated only by the High Court or the Court of Small Causes, Bombay, as stated above.

12. A copy of the account of the assessee in the books of Sarupchand Prithiraj will be found at Exhibit I. From it, it will appear that on April 25 the assessee earned a profit of dollars 5,686.20 and they withdrew the same that day in cash and they admit that. As regards the profit of dollars 29,043.50 for which credit was given to them on July 18th, 1933, they said to the Assistant Commissioner that they ordered Messrs. Sarupchand Prithiraj that very day to invest it in New York. Similarly as regards the profit of dollars 8,500.40 which was credited to their account on August 21, 1933, they said that they gave an order on August 28 to invest the same in New York. To test the truth of these statements I called for the accounts of Messrs. Sarupchand Prithiraj when I found that they have noted that the said two amounts were paid in cash through the National City Bank of New York on July 18, and August 21, 1933, as will be clearly seen from Exhibit I, J and M.

13. Questions for the decision of the Honourable Court.—I submit for decision the following questions of law :—

(1) In the circumstances of the case, would it be correct (a) to treat the profit of dollars 29,043.50 and dollars 8,500.40 as having accrued or arisen in British India or (b) deem it to have so accrued or arisen, within the meaning of Section 4 (1) of the Act.

(2) In the circumstances of the case, would it be correct to treat the above two items of profit as having been received in British India within the meaning of above Section 4 (1) of the Act.

14. Opinion of the Commissioner.—As Section 66 (2) of the Act requires me to give my opinion while submitting this Statement of the Case, I submit that the answer to both the questions should be in the affirmative. This case is quite different from the case of Mr. Chunilal B. Mehta (High Court Civil Reference No. 11 of 1934) decided by your Lordships in March 1935. In that case, the assessee was dealing directly with the New York and Liverpool brokers. In the present case, the assessee is dealing with a firm of brokers and speculators in Bombay. The real state of affairs as regards cases of this kind is that the assessee enters into certain contracts and later on disposes of them. He gains or loses according as he realises something more or less when the contract is disposed of. These transactions are not in reality those for actual

purchase or sale of commodities. It is only with the object of preventing the parties from pleading that the contracts are of a wagering nature that the stereotyped condition that actual delivery is contemplated is always introduced in the contract form. As a matter of fact, no delivery is ever intended to be taken in such cases and in this particular case, there is no written contract even embodying any such condition as regards delivery nor was it ever taken nor could it have been contemplated. The sole object is to enter into contracts to purchase or sell and then dispose of them. Now the assessee entered into the contracts which brought them the above profit with Messrs. Sarupchand Prithiraj in Bombay and disposed of them in Bombay. The latter were alone responsible to them and they were bound to pay to the assessee the resulting profit in *Bombay*. The New York brokers did not recognise the assessee and there was no privity of contract between these two parties. How can the profits be said to have accrued or arisen in New York as the assessee alleges, when they had no right to receive it there? Just as they would have had to pay to Messrs. Sarupchand Prithiraj in Bombay any loss accruing from the transaction, so they had a right to receive the profit, if any, in Bombay and such profit can therefore only be said to have accrued and arisen in Bombay. Income cannot be said to have accrued at a particular place to an assessee unless he has a right to receive it there.

15. That Messrs. Sarupchand Prithiraj were bound to pay the said profit in Bombay is an admitted fact. Hence, even assuming for a moment that it could reasonably be contended that the profit had accrued at New York, it must surely be taken to have been brought to Bombay the moment Messrs. Sarupchand Prithiraj credited it to the account of the assessee in their account books in Bombay as unless it was so brought and kept ready for payment on demand, it could not possibly be paid on demand made by the assessee. For example, the profit of dollars 5,686 realised on April 25, 1933, was actually credited to the assessee's account on that very day and was admittedly paid in cash that day to the assessee. Unless it was brought to Bombay, it could not have been paid in Bombay. Similarly the profit of dollars 29,043.5 was credited to the assessee's account in Bombay on 18th July and as under the contract made, it was to be paid in Bombay, it must have been brought to Bombay and kept ready for payment on demand the moment it was credited to the assessee's account. Now Section 4 (2) of the Act lays down that profits accruing or

arising abroad to a person resident in British India shall be *deemed* to have accrued or arisen in British India if they were received in or brought into British India. In this case, the profits were brought into British India as soon as they were made and so they must be deemed to have accrued or arisen in British India. Section 4 (1) of the Act states that the Act applies to profits which are deemed under the provisions of the Act to accrue or arise in British India. As the profit in this case is, under Section 4 (2) of the Act, to be deemed to have accrued and arisen in British India, Section 4 (1) must apply thereto. The assesseees tell me that as the account is in dollars, it cannot be said that the money was brought here. I do not think this matters at all as, as a matter of fact, profit can be brought here only in dollars if it is made in America. Also Section 4 does not refer to profit in rupees only. It may be in any other currency.

16. As regards the second question, from the extracts from the accounts of Messrs. Sarupchand Prithiraj annexed hereto as Exhibits I, J and M, it will be clear that the assesseees received the profit in Bombay as soon as it was credited to their account in Bombay. As a matter of fact from the moment it was placed at their disposal, they must be taken to have received it. Before the Assistant Commissioner, they tried to explain that they had asked Messrs. Sarupchand Prithiraj to invest it in New York after it was received in Bombay but the real meaning of such an order would be that the assesseees received the money in Bombay and handed it back to Messrs. Sarupchand Prithiraj to invest it in New York. A man can receive money by actually putting the money into his pocket or keeping it at his disposal or under his control in some bank or with someone else. It is all, however, one and the same. Money is received by a person as soon as it is placed at his disposal. Moreover the actual wording of Section 4 (1) in this connection is that the "Act applies to all income, profits or gainsreceived in British India". The profit in this case must undoubtedly be taken to have been received in British India as soon as it was placed at the disposal of the assesseees in their account in Bombay with Messrs. Sarupchand Prithiraj. The condition was that the profit was payable in Bombay and unless it was received in Bombay, it could not be payable there. Hence the question must be answered in the affirmative.

17. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act."

The Advocate General with the *Government Solicitor* for the Referor.

Mr. Munshi with *Mr. Pettigara* with *Messrs. Mulla & Mulla* for the Assessee.

JUDGMENT.

BEAUMONT, C. J.—This is a Reference made by the Commissioner of Income-tax under Section 66 (2) of the Income-tax Act. The assessee is a firm trading in Bombay, and they do a good deal of business in cotton and other commodities. The profits on which they have been assessed, as they say wrongly, in this case, were derived from certain contracts for the purchase and sale of cotton placed on the New York Exchange during the year of assessment, which is the year 1934-35. It was held by this Court in *Chunilal Mehta's* case, (1935) 37 Bom. L.R. 753, that where a broker in Bombay makes profit out of contracts placed by him with a broker on a foreign exchange, the profits are made out of the contracts which the broker on the foreign exchange carries through, and those profits do not accrue or arise in British India. But the Commissioner of Income-tax is of opinion that this case should be dealt with on a different footing, because the contract entered into by the assessee and the brokers was in the first instance entered into with brokers in Bombay, who themselves placed the orders on the New York Exchange. It is apparent, therefore, that it is important to know what were the terms of the contract between the assessee and the brokers in Bombay. Unfortunately that contract is not in writing, and the findings of the Income-tax Officer are a little vague. But, at any rate, we have this to go upon. We have the fact that certain brokers in Bombay, Messrs. Sarupchand Prithiraj, placed orders with brokers in New York for the purchase of forward cotton. The brokers in New York notified Messrs. Sarupchand Prithiraj that they had carried out the contracts of purchase on certain terms. Then we have orders from Sarupchand Prithiraj, the brokers in Bombay, directing cotton bales to be sold, and subsequent notification from the New York brokers as to the terms on which the bales had been sold. Then we have a statement of account delivered by Sarupchand Prithiraj to the assessee dealing with the sale and purchase of cotton bales which formed part of the cotton bales to which the orders placed by Sarupchand Prithiraj in New York applied. So that apparently Sarupchand Prithiraj directed purchase or sale of bales not only for the assessee, but for other clients. There are

two statements of account which are relevant, between Sarupchand Prithiraj and the assesseees. Those are Exhibit H and Exhibit N. Exhibit H shows a profit of 29,000 dollars on the sale and purchase of 2,000 bales of cotton for March 1934, and Exhibit N shows a profit of 8,500 dollars on 4,000 bales of cotton bought and sold for May 1934. It further appears from Exhibit J that the 29,000 odd dollars due as shown in Exhibit H was actually paid by Sarupchand Prithiraj to the assesseees through the National City Bank of New York in dollars and the 8,500 dollars as appears from Exhibit M, was similarly paid in New York to the assesseees, and the moneys have been allowed to remain in New York. It is plain from those transactions, which are evidenced by written documents, that there must have been a contract between the assesseees and Sarupchand Prithiraj for the purchase and sale of the bales in respect of which the profits were actually paid over to the assesseees. The Income-tax Officer in dealing with the terms of the contract between the assesseees and Sarupchand Prithiraj did so by reference to his finding for the year 1932-33 in respect of contracts which seem to have been in somewhat different terms. But I think his finding really comes to this. He thinks that in all probability there was a written contract between the assesseees and Sarupchand Prithiraj, though he says that the parties deny that. But he says there must at any rate have been some contract, and if it was not in writing, it must have been oral, and he then obtains from Sarupchand a form of contract which they usually enter into, and he assumes that the contract with the assesseees if made orally, was upon the usual terms of Sarupchand Prithiraj's contracts. I am certainly not prepared to say that there is no evidence on which the Income-tax Officer could properly arrive at that finding, which, I think, is probably correct. At any rate it seems to me perfectly plain from the documents we have got that the assesseees must have instructed Sarupchand Prithiraj to enter into transactions for them on the New York Exchange. Sarupchand Prithiraj, as the documents show, dealt directly with the brokers, and ultimately a profit is derived, and, in my opinion, as between the assesseees and Sarupchand Prithiraj, the profits are derived on the contract made with Sarupchand Prithiraj, and the profits were actually paid on that contract, and as that contract was made in Bombay, (whether or not the moneys were to be paid in Bombay seems to me immaterial), and resulted in profits, it seems to me those profits accrued or arose in British India, and that the case is quite different from *Chunilal*

Mehta's case, in which there was no contract made in Bombay under which any profits arose or could have arisen. The learned Commissioner has referred two questions. The first one is, in the circumstances of the case, would it be correct (a) to treat the profit of 20,043.50 dollars and 8,500.40 dollars as having accrued or arisen in British India or (b) to deem it to have so accrued or arisen, within the meaning of Section 4 (1) of the Act? Then there is a second question as to whether those two items of profit should be treated as having been received in British India within the meaning of the above Section 4 (1) of the Act. In my opinion the answer to Question (1) (a) should be in the affirmative, and the other questions do not therefore arise. Assesseees to pay the costs of the Commissioner of Income-tax on the Original Side scale to be taxed by the Taxing Master less Rs. 100.

BLACKWELL, J.—I am of the same opinion. Mr. Munshi for the assesseees has contended that the true inference to be drawn from the statements in the case and from the documents is that the assesseees were undisclosed principals, and that they could have enforced in New York against the brokers employed by Sarupchand Prithiraj the contracts which those brokers made in New York. In my view it is impossible to say that there was no evidence upon which the Commissioner came to his conclusion that the contracts with the New York brokers were between Messrs. Sarupchand Prithiraj and themselves and not the assesseees, and that the New York brokers recognised Messrs. Sarupchand Prithiraj only. If there was evidence upon which the Commissioner could so hold, it obviously disposes of Mr. Munshi's submission that the true inference was as he suggests. That was a question of fact for the Commissioner to decide on the evidence before him. Moreover the Commissioner states that it was an admitted fact that Messrs Sarupchand Prithiraj of Bombay were responsible to the assesseees only, that all profit earned was payable in Bombay by the latter to the assesseees, and that it was agreed that any dispute as regards the contract entered into was to be adjudicated only by the High Court or the Court of Small Causes, Bombay. Mr. Munshi has submitted that there was no evidence that such admissions were made. But we must, I think, assume that the Commissioner of Income-tax certainly would not have stated that those facts were admitted facts unless there had been statements or evidence before him that they were in fact admitted. Consequently on the findings of the Commissioner it is obvious that the only profits and losses receivable and payable were receivable and payable by

the assessee out of the contracts made in Bombay by them with Sarupchand Prithiraj and not otherwise. On the findings, they had nothing whatever to do with the manner in which the instructions which they gave in Bombay were carried out in New York. They had no right to look to the brokers in New York for payment of any profits in New York, and they were not liable to the brokers in New York for any losses incurred. On the Commissioner's finding it seems to me plain that Question (1) (a) must be answered in the affirmative. In view of the answer to this question, I think it unnecessary to deal with the other questions.

Reference answered accordingly.

[IN THE KING'S BENCH DIVISION].

DOWN (H. M. INSPECTOR OF TAXES) v. COMPSTON.

LAWRENCE, J.

March 18, 1937.

CASUAL AND NON RECURRING RECEIPTS NOT ARISING OUT OF BUSINESS—PROFESSIONAL GOLFER—WINNING FROM BETS ON PRIVATE GAMES OF GOLF—WHETHER PROFITS OR GAINS—ASSESSABILITY.

The assessee was a professional golfer attached to a golf club. He habitually engaged in private games of golf on handicap terms, principally with and against amateurs, for bets of varying amounts, and won substantial sums for a number of years:

Held, that the assessee's winnings did not arise from his employment or vocation; they were in no way analogous to gratuities for service rendered; and as there was also no organisation in the case to support the view that he was carrying on the business of betting on the private games of golf, the winnings were not assessable to income-tax.

Cases referred to:

COOPER v. BLAKISTON [1909] (5 Tax Cas. 347; 1909 A. C. 104; 100 L.T. 51).

GRAHAM v. GREEN [1925] (9 Tax Cas. 309; 1925, 2 K. B. 37; 94 L.J.K.B. 494).

Case stated under the English Income-tax Act, 1918, Section 149 for the opinion of the King's Bench Division of the High Court of Justice.

The Attorney General (Sir Donald Somervell, K. C.) and Mr. Reginald P. Hills, for the Crown.

Mr. Raymond Needham, K. C., and Mr. J. S. Scrimgeour, for the Assessee.

JUDGMENT.

LAWRENCE, J.—The only provision of the Income-tax Acts to which my attention has been drawn in this case is the Rule applicable to Case II of Schedule D, which provides: "The tax shall extend to every employment by retainer in any character whatever, whether such retainer shall be annual or for a longer or shorter period, and to all profits and earnings of whatever value arising from employments". The question is whether the winnings which the Respondent makes upon bets on golf matches arise out of his employment or vocation as a golf professional. The Case states that he has made substantial sums of money during a number of years by making bets on private games of golf which he has played during those years. The argument for the Crown is, as I understand it, that there is in this case the vocation of a golf professional, and that the winnings on bets on golf matches played by a golf professional are in the course of his vocation as a golf professional and arise out of that vocation, and that therefore it is not necessary to find that there are so many transactions or such an organisation of these betting transactions as to constitute a separate employment or vocation in itself; but it is said that, as the Respondent has the vocation of a golf professional, the winnings which he makes in these matches occur in the course of and arise out of that vocation and are therefore taxable, just as much as the Easter offerings of a clergyman or the gratuities of a waiter. On the other hand, on behalf of the Respondent it is contended that the winnings of the Respondent do not in any true sense arise out of his vocation, they arise from the bets and not from his vocation as a professional golfer; his vocation as a professional golfer merely affords the opportunity for making the bets and does not give rise in any proper sense to the winnings from the bets. It was pointed out by Mr. Needham on behalf of the Respondent that the argument for the Crown would have to go the length of saying that every receipt which was in any way connected with an employment or vocation would be taxable and, as an illustration, he gave the possible case of a ship's officer making wagers upon the run of the ship for the day. He contended that such a wager as that would be as closely connected with the

ship's officer's employment or vocation as are the bets which the Respondent makes upon his private games of golf.

Mr. Needham also contended that these winnings cannot be properly looked at as gratuities for the services of the Respondent in playing with the people with whom he plays these private games, and he drew my attention to the case of *Cooper v. Blakiston*, (5 T.C. 347 at page 355) where the Lord Chancellor said: "Where a sum of money is given to an incumbent substantially in respect of his services as incumbent, it accrues to him by reason of his office. Here the sum of money was given in respect of those services. Had it been a gift of an exceptional kind, such as a testimonial, or a contribution for a specific purpose, as to provide for a holiday, or a subscription peculiarly due to the personal qualities of the particular clergyman, it might not have been a voluntary payment for services, but a mere present". Mr. Needham suggested that that was the true rule in this matter, that it is right to look to see whether the alleged gratuity is substantially in respect of the services rendered. He contended that the very disparity between the ordinary fee which would be paid for a professional playing a round of golf and the sums won upon these bets emphasised the distinction between a gratuity for services rendered and bets such as these. I may add that the distinction is still further emphasised by the possibility of bets involving losses.

Mr. Needham also contended that, apart from the analogy between these bets and gratuities for services rendered, it was impossible for the Crown to sustain their argument on the view, which is suggested in the argument before the Commissioners, that the Respondent organised his effort in the acquisition of money through the exploitation of his skill and reputation as a professional golfer, and he contended that there was no more organisation by the Respondent than there was in the case of *Graham v. Green* by the person involved in that case who made his living out of backing horses.

I am in agreement with the argument which has been presented for the Respondent and with the decision of the Commissioners in this case, and I hold that the winnings of the Respondent did not arise from his employment or vocation and that they are in no way analogous to gratuities for services rendered; and, lastly, if it is necessary to look to the question of organisation, that there was no organisation in this case which would support the view that the Respondent was carrying on a business of betting on these private games of golf.

For these reasons, I am of opinion that the appeal must be dismissed with costs.

Appeal dismissed.

[IN THE KING'S BENCH DIVISION]

COMMISSIONERS OF INLAND REVENUE v. LEDGARD.

LAWRENCE, J.

March 18, 1937.

INCOME AND CAPITAL—PARTNERSHIP—PURCHASE MONEY PAID FOR SHARE OF DECEASED PARTNER IN FIRM—PAYMENTS BASED ON SHARE OF PROFITS FOR A NUMBER OF YEARS AFTER DEATH—WHETHER INCOME OR CAPITAL.

An agreement of partnership provided that 'the purchase money for the share of a deceased partner shall be such a sum of money as the personal representatives of the deceased partner and the surviving partners may agree upon and failing such agreement the purchase money shall be a sum equal to one half of the share of profits for three years commencing from the first day of the month immediately following the death of such partner which would have been payable to the deceased partner had he continued to be a partner.' It was also provided that the decision of the auditors for the time being of the firm as to the amount of the purchase money payable was to be final and binding and no payment on account of the purchase money was to be required until it had been ascertained unless the remaining partners were willing to make payment on account. One of the partners died in June 1933 and his legal representatives were paid £358 and £571 for the years ending 31st December 1933 and 31st December 1934 respectively in accordance with the latter portion of the abovesaid provision.

Held, that on the construction of the partnership agreement the purchase money was not a lump sum to be paid in instalments, but a lump sum to be paid at the end of three years when it had been ascertained by auditors, and the payments made were capital and not income.

Cases referred to:

CHADWICK v. PRARL LIFE INSURANCE Co. [1905] (2 K.B. 507; 74 L.J.K.B. 671; 98 L.T. 25; 21 T.L.R. 546).

COMMISSIONERS OF INLAND REVENUE v. RAMSAY [1935] (20 Tax Cas. 79; 154 L.T. 141; 79 S.J. 987).

DOTT v. BROWN [1936] (1 All. E.R. 543 ; 154 L.T. 484).

GLENBOIG UNION FIRECLAY Co. v. COMMISSIONERS OF INLAND REVENUE [1921] (12 Tax Cas. 427).

The Solicitor-General (Sir Terence O'Connor, K. C.) and Mr. Reginald P. Hills for the Crown.

J. S. Scrimgeour for the Assessee.

JUDGMENT.

LAWRENCE, J.—In this case the question is whether the purchase money for a deceased partner's share is capital or income for the purposes of the Income-tax Acts. The Special Commissioners have decided that the purchase money for the deceased partner's share in this case was income. I regret to say that I find myself unable to agree with the Special Commissioners in this case. It has been laid down in the Court of Appeal in *Commissioners of Inland Revenue v. Ramsay*, that the real substance of the transaction is the matter which must be considered: (20 T.C. at p. 94).

In the agreement of the partnership, which was a partnership of architects, it was agreed by Clause 17 that, on the death of one of the partners, "the purchase money for the share of a deceased partner shall be such a sum of money as the personal representatives of the deceased partner and the surviving partners may agree upon and failing such agreement the purchase money shall be a sum equal to one half of the share of profits for three years commencing from the first day of the month immediately following the death of such partner which would have been payable to such deceased partner had he continued to be a partner during the said period of three years". By clause 18 it was provided: "The decision of the auditors for the time being of the firm as to the amount of any purchase money payable under the two preceding clause shall be final and binding upon all interested parties and no payment on account of such purchase money shall be required until the same shall have been actually ascertained unless the remaining partners are willing to make payments on account thereof". Those are the two clauses which govern the matter in this case.

It appears that the remaining partners, who were also executors of the deceased partner, did not carry out strictly the terms of the partnership agreement. They did not agree, as they might have agreed under Clause 17, upon the purchase money of the share of the deceased partner, but they took a sum equal to one half of the share of the profits from the 1st July, 1933, which was

the first of the month after the death of the deceased partner on the 25th June, 1933, up to the 31st December, 1933 and they then took a similar share of profits from 31st December, 1933, up to the 31st December, 1934, and they paid over those sums to the personal representatives of the partner under deduction of income tax.

The argument which has been presented to me on behalf of the Respondents is that the true construction of this partnership agreement is that the purchase money for the deceased partner's share should be paid in three annual instalments, and that, having regard to the fact that there was no previously quantified or fixed sum, the sums which had to be paid for the deceased partner's share which are to be fixed by reference to the profits of the partnership for the three years following the death of the deceased partner are income for the purposes of the Income Tax Acts. Mr. Scrimgeour contends that the true construction of the partnership deed is that that purchase money is to be paid in instalments, and that the partners did carry out the true construction of that agreement; and that fact, coupled with the fact that the sums so to be paid were dependent upon the fluctuation of the profits of the partnership business, renders the sums so to be paid income and not capital. He relies upon the dictum of WALTON, J., in *Chadwick v. Pearl Life Insurance Company* and upon *Ramsay's case* which I have already cited, in which the purchase money for a dentist's business, which was there in question, was fixed by the agreement of sale at £15,000 and it was held that, although that sum was to be satisfied by ten annual payments of 25 per cent. of the net profits of the business, which obviously might be more or less than £15,000, those annual payments were capital because they related to the previously quantified or fixed sum. It may be that there would be much force in that argument in the present case if the true interpretation of this partnership agreement was that the purchase money was to be paid by annual instalments out of the profits of the partnership business without quantifying the amount of the purchase money in any share or form. But in my judgment, that is not the true interpretation of the partnership agreement.

I think that the dictum of SCOTT, L.J., in the case of *Dott v. Brown*, at page 550 commenting upon the dictum of WALTON, J., in *Chadwick v. Pearl Life Insurance Company* is relevant to the present matter. There he says after quoting WALTON, J., "The distinction is a fine one, and seems to depend on whether the

agreement between the parties involves an obligation to pay a fixed gross sum'. Now, that phrase is an illustration of the danger of taking a particular signpost as having more meaning than that of mere signpost. The words 'fixed gross sum' are a phrase that may mislead if stated as a final test. Take a very simple case—a sale for a lump sum, which is to be paid ultimately by reference to certain subsequent considerations affecting the amount—a sort of arrangement that the ultimate sum payable may be higher or lower as the value of the property sold may turn out to be more or less, a perfectly natural and not uncommon transaction in the sale of certain types of property, particularly where goodwill is included in the sale. No fixed sum is there defined because the true essence of the transaction is that the consideration shall vary according to future calculations depending on certain facts. To say that, because in that transaction the sum might so vary it was not a capital payment, would be an erroneous conclusion". Similarly, in my judgment, it is erroneous to say in this case that this is not a capital payment because the purchase money for the deceased partner's share is to be dependent upon what the profits of the business are for the three years succeeding the death of the deceased partner. It is, I think, a fairly common method of arriving at the value of a share in a business, a large part of which share is dependent upon goodwill, to ascertain the value of that share by reference to the profits of the business over a certain term of years. In my judgment that is what was done in this case. Clause 17 simply provides for a method of valuing the deceased partner's share of the business, including therein the goodwill; and, as Lord Buckmaster said in *Glenboig Union Fireclay Company Ltd. v. Commissioners of Inland Revenue* (12 T.C. 427, at page 463), the fact that annual profits, which are, of course, of an income character, are used as the measure of the sum does not affect the quality of the sum which is arrived at by that method.

I hold upon the construction of this partnership agreement that it was not a lump sum to be paid by instalments, but was a lump sum to be paid at the end of the three years, when it had been ascertained by the auditors. That seems to me to be clear upon the construction of Clauses 17 and 18, which speak throughout of the purchase money in the singular, which is to be agreed upon by the partners, or failing agreement, is to be a sum equal to one half of the share of profits for the three years commencing from the first day of the month immediately following the death of such partner which is to be determined or decided by the auditors

for the time being, and no payment is to be required on account until the sum shall have been actually ascertained. In my judgment that contemplates one ascertainment of one sum, and not the ascertainment of three or more instalments. I am, therefore, of opinion that the payment for the deceased partner's share in this case is capital and not income.

The appeal will be allowed with costs.

Appeal allowed.

[IN THE BOMBAY HIGH COURT.]

COMMISSIONER OF INCOME-TAX, BOMBAY

v.

NEW INDIA ASSURANCE CO. LTD.

SIR JOHN BEAUMONT, C.J., and KANIA, J.

March 23, 1938.

FOREIGN INCOME—INTEREST ON FOREIGN SECURITIES—INTEREST NOT REMITTED TO BRITISH INDIA BUT INCLUDED IN BALANCE SHEET AND IN DETERMINING AMOUNT PAYABLE AS DIVIDEND TO SHAREHOLDERS—WHETHER ASSESSABLE IN BRITISH INDIA—INDIAN INCOME TAX ACT (XI of 1922), Sec. 4 (1).

The assessee, the New India Assurance Co. Ltd., had its head office in Bombay and carried on the business of insurance in India and abroad. During the year of account it had an income of Rs. 79,000 from dollar securities and 2 lacs and odd from sterling securities. This interest was invested outside British India and remained there. In the accounts of the company the total profits were shown at a sum of 8 lacs and odd rupees and in those total profits interest on these foreign investments was included. The profits were then dealt with by a declaration of dividend which absorbed nearly 6 lacs leaving over 2 lacs to be carried forward to the next year's account. It was contended on behalf of the Crown that though the interest on foreign investments was not actually remitted to British India it was received in British India inasmuch as the company had included it in the total profits shown in the balance sheet and had also taken it into account in determining the amount to be paid as dividend to shareholders. Held, overruling the contention of the Crown, that the interest was not received in British India and was not assessable to income tax under the Indian Income Tax Act.

The mere fact that income earned abroad by a company registered in India has been brought into account in ascertaining its profits for the year and has been taken into account also in determining the amount to be paid in dividend will not make the income taxable in British India unless it is also proved that this actual income has been received in India.

Case stated under Section 66 (2) of the Indian Income Tax Act, 1922, by the Commissioner of Income Tax, Bombay.

STATEMENT OF CASE.

“Under Section 66 (2) of the Indian Income tax Act, XI of 1922, (hereinafter referred to as “the Act”) and at the instance of the New India Assurance Company Limited (hereinafter referred to as “the assessee company”), I have the honour to submit for your Lordships’ decision the questions, of law, set out in paragraph 9 below, which have arisen out of the income tax and super tax assessments of the assessee company for the financial year 1935-36, ended on 31st March 1936.

2. **Facts of the Case.**—The assessee company has its Head Office in Bombay and carries on fire, marine and accident insurance business in this country and abroad. For the financial year 1935-36, it was assessed by the Income tax Officer Companies Circle, Bombay, to income tax on a total income of Rs. 5,07,970 and to super tax on a total income of Rs. 7,80,028, the total amount of tax payable being Rs. 1,15,802-11-0 including the surcharge. A copy of the Assessment Order passed on 10th March 1936 by the Income Tax Officer, Companies Circle, Bombay, is annexed hereto and marked Exhibit A. A copy of the printed annual Report and Accounts of the assessee company for the year ended 31st March 1935 on which the said assessment has been based is also annexed hereto and marked Exhibit B. It will be seen therefrom that the company computes separately its profit from the Fire, Marine and Life insurance branches of its business and takes the profit from each branch to a general Profit and Loss Account (*vide* pages 6 and 7 of the Annual Report Exhibit B). It has worked out a profit or surplus of Rs. 4,03,706-6-8 from the Fire insurance business and Rs. 1,13,945-14-9 from the Accident insurance business. Instead of taking to the general Profit and Loss Account the whole of these items of profit, however, it took Rs. 1,75,000 from the former and Rs. 90,000 from the latter to the Additional Reserve Account and carried to the general Profit and Loss Account only the balance of Rs. 2,28,706-6-8 and Rs. 23,935-14-9 respectively

from the said two items. The Income tax Officer objected to the transfer of the said sums of Rs. 1,75,000 and Rs. 90,000 to the Additional Reserve Accounts on the ground that the transfer of 100 per cent. of the premium income was more than enough for ordinary and extraordinary risks outstanding, and that no data had been furnished with a view to justify what appeared to him an excessive provision. He therefore allowed only Rs. 1,20,470 and Rs. 85,784 respectively, a provision which brought the total reserve in each case up to the amount of the premium income. Income from business is ordinarily to be computed as laid down in Section 10 of the Act under which no such reserves are allowed. In the case of insurance business, however, special rules have been framed by the Central Board of Revenue under the powers vested in it under Section 59 of the Act. Rules 28 and 29 apply to fire, marine and accident insurance business of a company incorporated in British India and Rule 29 under which an allowance on account of reserves is permissible is as under :—

“ If in the ordinary accounts of any insurance business other than Life Assurance, Annuity or Capital Redemption Business, carried on by an Insurance Company any amount is actually charged against the receipts for the sole purpose of forming a reserve to meet outstanding liabilities or unexpired risk in respect of policies which have been issued (including risk of exceptional losses) and is not used for any other purpose such amount may be treated as expenditure incurred solely for the purpose of earning the profits of the business.”

In view of the wording of the Rule, the Income tax Officer held that he had discretion to allow so much only on account of these special reserves as he thought reasonable, and accordingly declined to allow more than the amounts above mentioned.

3. As stated above, the company carries on business not only in India but in other parts of the world, viz., the United States of America, England and Africa. The result of such business done *outside* British India is also incorporated in the head office accounts and the profit or loss made in respect thereof is accounted for here and tax has in fact been paid on the total income thus arrived at, for years past. The assessee company admits its liability on this account and no dispute has arisen in connection therewith.

4. The separate figures supplied to the Income tax Officer by the Company for its United States of America and London

business as also in respect of interest on investments held there are as under :—

1. American Fire Insurance business.

	Dr. Rs.	Cr. Rs.
Premium reserve at the beginning of the year		6,94,117
Premium received during the year		7,74,585
Interest received during the year		79,231
Claims paid	4,23,947	
Commission paid	3,31,469	
Taxes and charges	51,654	
Premium reserve at the end of the year	6,78,178	
Net profit	62,685	
Total	15,47,933	15,47,933

The net income of Rs. 62,685 was thus dealt with in the accounts :—Rs. 16,546 was debited as loss to the Fire Insurance Account, and Rs. 72,231 on account of interest was taken direct to the interest account and is included in the sum of Rs. 4,26,212 credited on account of interest to the general Profit and Loss account on page 7 of Exhibit B.

2. London Fire Insurance business.

	Dr. Rs.	Cr. Rs.
Premium reserve at the beginning of the year		7,16,852
Premiums		17,51,262
Interest		2,22,216
Claims paid	10,70,424	
Commission paid	6,06,825	
Taxes and charges	21,507	
Premium reserve at the end of the year	7,60,509	
Net profit	2,91,075	
Total	26,90,340	26,90,340

Just as in the case of the American Fire Insurance business, however, instead of the whole profit of Rs. 2,91,075 being carried to the Fire account, a sum of only Rs. 68,859 was taken to that account, the remaining Rs. 2,22,216 on account of interest being taken to the interest account and being included in the above sum

of Rs. 4,26,212 credited on account of interest in the general Profit and Loss Account on page 7 of the Report.

5. It will thus be seen that the profit in the various branches which appears in the Fire, Marine, Accident, etc., accounts on pages 6 and 7 of Exhibit B is the profit for the total world business and not the business pertaining to British India alone. From a glance at these accounts, it will also be clear that credit is given in each of them on account of the estimated interest on the reserves built out of profits earned in the past in that branch of business and premium income held in reserve. Out of the total interest earned on all its investments, the assessee company allocates to the Fire, Marine, etc., Insurance accounts, certain sums on account of interest estimated on the reserves held in respect thereof and the balance is taken to the general Profit and Loss Account as stated above. Thus for the year in question, after crediting Rs. 1,35,215-6-0 to the Fire Revenue Account, Rs. 97,837-8-3 to the Marine Revenue Account, Rs. 2,106 to the Accident Revenue Account and Rs. 98,410-13-11 to the Life Assurance Account, the balance of interest amounting to Rs. 4,26,212-14-0 has been credited to the general Profit and Loss Account on page 7 of the Report (Exhibit B). This splitting up of the total amount of interest earned into four separate accounts has, in fact, no significance as far as the computation of profit is concerned and the company could as well have credited the whole interest to the general Profit and Loss Account, or more properly have divided it out wholly amongst the four branches of its business as its assets are all held to meet liabilities on account of all of them combined. After adopting this method of accounting as regards its interest income, however, the assessee company has in its general Profit and Loss Account on page 7 of Exhibit B worked out a net profit of Rs. 8,31,822-7-10, including Rs. 2,19,822-6-9 brought forward from the preceding year. Excluding the said amount, the true profits for the year would be Rs. 6,16,500-1-1 only and as indicated on pages 4 and 5 of Exhibit B, almost the whole of it, *viz.*, Rs. 5,93,421-4-0 has been utilised in paying a dividend in Bombay to the shareholders.

6. Though the profits arrived at after including the total interest earned in all parts of the world was distributed here in Bombay amongst the shareholders of the assessee company, yet at the time of assessment, it was further claimed before the Income Tax Officer that as interest to the extent of Rs. 2,22,216 plus Rs. 79,231 or Rs. 3,01,448 in all was earned on sterling and dollar

securities and was received outside British India, it should be excluded from the income to be taxed. The Income tax Officer, however, declined to grant this claim for reasons stated in his Assessment Order, Exhibit A. (As regards this order, the Income tax Officer has subsequently explained that the word "Proves" in the sentence "Proves that the interest realised on foreign securities has been kept there" etc., was a mistake for the word "says", as noted by the Assistant Commissioner in his appellate order hereinafter referred to.)

7. Against the above assessment, the assessee company appealed to the Assistant Commissioner of Income tax, B Division, Bombay, objecting to the Income tax Officer's decisions as regards the items taken to the additional reserve accounts and the above item of interest. A copy of the petition of appeal is annexed hereto and marked Exhibit C. The Assistant Commissioner, after hearing the appeal, considered the assessment levied by the Income tax Officer to be in order and confirmed it. A copy of his order passed under Section 31 of the Act is annexed hereto and marked Exhibit D.

8. Being dissatisfied with this decision, the company has submitted to me a petition requesting me to refer the case under Section 66 (2) of the Act to this Honourable Court. A copy of the said petition is annexed hereto, marked Exhibit E. The following questions have been raised in that petition :—

"1. Whether the disallowance made by the Income tax Officer and by the Assistant Commissioner from the additional reserves in the Fire Insurance Account and Accident Insurance Account beyond 100 per cent. of the premium are valid and justified in law.

2. Whether the additional reserves taken into the above accounts by the company are not allowable in full under Rule 29 of the Rules made under the Act.

3. Whether the sum of Rs. 3,01,448 representing income outside British India on investments, which was held outside British India is liable to assessment under the Indian Income tax Act."

As regards questions 1 and 2, the Assistant Commissioner's finding is that as in Rule 29 of the Income tax Rules the word used is "may" and not "shall", the Income tax Officer had discretion to allow a reasonable amount only and I too being of the same opinion, gave an appointment to the Solicitors for the assessee company and requested them to state whether they wanted

this Honourable Court to decide the question whether the word "may" in the said Rule 29 should be interpreted as meaning "shall". They said, however, that they did not want to go so far. If the word "may" is not to be interpreted as meaning "shall", it follows that the Income tax Officer has discretion in the matter and in that case, the question which arises is one pertaining to the quantum of a reasonable allowance on account of additional reserves and that is a question of fact. It would therefore appear that I have no authority to refer the said questions to the Honourable Court. As regards the third question, the statement therein contained that the income referred to was held outside British India seems intended to suggest that such income was never received in British India. That is, in my opinion, not correct nor is it in accordance with the Assistant Commissioner's finding of fact. Hence the question as framed cannot be referred. The assessee company has, however, in its petition left it to me to refer such questions as may appear to me to arise in the case. Hence I refer the questions mentioned in the following paragraph.

9. Questions of Law for Decision By the Honourable Court—I submit the following questions for decision of the Honourable Court:—

"1. Whether the two sums of Rs. 79,231-10-0 and Rs. 2,22,216-9-6, being interest accruing without British India on dollar securities and sterling securities respectively, were in the circumstances of the case received in, or brought into British India;

2. Whether, if so, the assessee company is liable to be assessed in respect thereof."

10. Opinion of the Commissioner.—As Sec. 66 (2) of the Act requires me to give my opinion while submitting this statement of the Case, I beg to invite attention to pages 4 and 5 of the Annual Report of the Company, Exhibit B, in which under the head "Profit and Loss" the Directors state as under:—

"The approximate Interest earned by the Revenue Accounts has been credited to those Accounts. The remaining interest, plus transfer fees and exchange adjustments amount to Rs. 4,41,861-12-9. An amount of Rs. 2,28,706-6-8 has been transferred from Fire Account, Rs. 12,315-6-9 from Marine Account, Rs. 23,945-14-9 from Accident Account and Rs. 8,579-0-0 from Life Account.

After providing for all other outgo, and bringing in the balance of last year amounting to Rs. 2,15,322-6-9, there remains a

balance of Rs. 8,31,822-7-10, which the Directors recommend shall be dealt with as follows :—

“Payment of a dividend at the rate of Rs. 1-4-0 per share, which will absorb an amount of Rs. 5,93,421-4-0 leaving Rs. 2,38,401-3-10 to be carried forward to next account”.

11. From the above, it will be seen that taking into account every pie of the interest income *wherever earned* and the balance of profit of the preceding year amounting to Rs. 2,15,322-6-9, the balance for disposal was only Rs. 8,31,822-7-10 out of which Rs. 5,93,421 were utilised in paying a dividend to shareholders and the balance of Rs. 2,38,401-3-10 was carried forward to the following year. Excluding the balance of Rs. 2,15,322-6-9 carried forward from the preceding year, the profit for the year in dispute in which the interest income was included was Rs. 6,16,500 and almost the whole of it, *viz.*, Rs. 5,93,421 was utilised in paying dividends. Now the only ground on which the assessee company wants an exemption in respect of the two sums of Rs. 79,231-10-0 and Rs. 2,22,216-9-6 aggregating in all to Rs. 3,01,448 is that the said interest has not been brought to British India but held outside British India where it was received. If that were so, as the amount actually distributed here in Bombay to the shareholders did undoubtedly include the said interest amount of Rs. 3,01,448, how could it have been so distributed here? Excluding the amount from the profit of Rs. 6,16,500 for the year, the balance available for distribution would be Rs. 3,15,052 only and as much as Rs. 5,93,421 could certainly never be distributed out of that much amount. Only the said amount of Rs. 3,15,052 could have been distributed here in that case and the balance distributed in London and New York but that is not the case, as every pie has been distributed here. Moreover, the accounts of the assessee company do not at all show that the said interest income has been accumulated abroad and would be available for distribution in future. The said interest items disappeared altogether from the foreign accounts, the moment they were brought to account in the Bombay account books and they ceased to exist in any shape whatever, the moment the above dividend was paid. If the interest earned had not been paid away by way of dividend as argued by the assessee company, surely it would be available for distribution in the following year or years. Is it so available for distribution a second time? The company cannot but admit that it is not so available and in that case, the income has to be taken as utilised in paying dividend and as it has been so utilised here in Bombay, it must be taken to

have been brought here. The assessee company has further argued before me that the said dividend was actually paid out of Rs. 4,50,000 borrowed on a promissory note from the Central Bank of India on 21st October 1935 and has sent to me an uncertified copy of the said promissory note which of course cannot and does not state that amount was borrowed for the payment of the dividend declared. The company has not stated in its Annual report (Exhibit B) that the dividend is to be paid from borrowed money. It has stated that it is to be paid from the profit earned including the interest earned abroad and this action on its part leaves no room whatever to infer that the dividend was paid from borrowed money. Again if, as is suggested, the Company in fact saved the actual transmission of the said moneys from abroad by the expedient of using a capital sum raised on loan in this country to pay the dividends here and retaining the money received by way of interest for the necessary investment there for the purposes of its business and to comply with the local laws, the case would be entirely covered by *Scottish Mortgage Co. of New Mexico v. McKelvie* (2 Tax. Cases 165), and the interest must be considered to have been received in British India.

12. As stated in the preceding paragraph, the balance of profit carried forward from the preceding year was Rs. 2,15,322-6-9 and adding to it Rs. 6,16,500 on account of profit for the year concerned, the amount at the disposal of the company was Rs. 8,31,822-7-10 and out of this sum, Rs. 5,93,421 were distributed to the shareholders. The assessee company has not advisedly taken up the point that the amount distributed be taken to consist of Rs. 2,15,322 on account of the profit carried forward and Rs. 3,71,099 out of the profit for the year in dispute, as, in case we are to hold that the foreign interest income is to be taken as included in the amount carried forward, it would follow that the said amount of Rs. 2,15,322 carried forward from the preceding year represents such interest which was not taxed in the preceding year and which should therefore be taxed in the year under consideration as having been received that year and utilised in paying dividends. The course will be unfavourable to the assessee company since the company having not been taxed in the past on such interest, it will mean its paying tax thereon for one year more than the years for which it could be assessed under the law, taking due account of the provisions of Section 34 of the Act.

13. Again turning to the figures pertaining to the London and the United States of America accounts given in paragraph 4

above, it will be seen that without taking into account any interest earned there, the company works out a loss of Rs. 16,546 in the United States of America account which it sets off against the income earned here and a profit of Rs. 68,859 in the London account which it includes in the income earned here and is prepared to pay tax without claiming any deduction on its account, as it has to be taken as brought here, having been included in working out the profit actually distributed here amongst the shareholders. The case is, however, exactly the same as regards the interest income earned at those places and included in working out the profit distributed here. It would be really meaningless to include the one and exclude the other, while computing the taxable income.

14. From the figures given in paragraph 4 above, it will be seen that in America, as much as Rs. 8,07,070 were paid away on account of claims and expenses. The company suggests, that the said payments be taken as made from premiums received and past reserves and not from interest income. There is no reason whatever, however, why payments made in America be taken as made out of certain receipts only and not all receipts. Similarly from the London account, it will be seen that payments made there amounted to as much as Rs. 16,98,756 and to say that they were made out of reserves and premium income and not out of all receipts is unreasonable. All the money held by an Insurance Company is liable for losses incurred in its business and the interest income earned by it is part and parcel of its trading receipts. Attention is invited to the case of the *Liverpool and London and Globe Insurance Company v. Bennet* (VI Tax Cases, page 327). JUSTICE HAMILTON in his judgment in that case says that "the funds received from the investments are just as much part of the receipts of the business, and the making of the investments is just as much part of the mode of conducting the business, as the taking of the risks" and that "the employment of these funds is essentially in and part of the business" (pages 358 and 359 *ibid*). Hence the interest income has to be treated on exactly the same footing as the premium income and as much liable for the payment of claims and expenses as the premium income.

As a matter of fact, in the case of companies with business activities in various parts of the world, there are receipts and payments and movements of funds through banks one way or the other and the only sure test to find out whether income, earned abroad has been kept there intact or otherwise is to see whether

it has been utilised in payment of dividend here and if it is so utilised as in this case, as this can only be done by bringing it here, the proposition that it has been retained outside British India can never stand.

15. The explanation to Section 4 (2) of the Act does not apply as the interest income in this case is not only taken into account in the Balance Sheet but has been actually distributed amongst the shareholders.

16. For the above reasons I am respectfully of opinion that the answer to both the questions should be in the affirmative.

17. A copy of your Lordships' decision may kindly be certified to me for further action as required by Section 66 (5) of the Act.

The Advocate General with the *Government Solicitor*, for the Commissioner.

Taraporewalla with *Messrs. Payne & Co.*, for the Assessee.

JUDGMENT.

BEAUMONT, C.J.—This is a reference by the Commissioner of Income tax under Section 66 (2) of the Indian Income tax Act in which he raises the question, whether two sums of seventy-nine thousand and odd rupees and two lacs and odd rupees respectively being interest accruing without British India on dollar securities and sterling securities respectively, were, in the circumstances of the case, received in, or brought into British India.

The learned Advocate General has contended in the first instance that this is really a question of fact which ought not to have been referred to us. No doubt, the question whether or not the sums were actually received in British India, is a question of fact, but, if the sums were not actually received, the question whether they ought to be treated as constructively received, is a question of law. Unfortunately, the learned Commissioner of Income tax has not stated the facts of the case very clearly in this reference. The reference in part concerns a question as to the construction of Rule 29, which eventually was not raised, and the material facts as to this interest on foreign investments are not found with clarity. However, the learned Advocate General has admitted, for the purposes of this reference, that the income on these foreign investments has not been actually received in British India, but on the contrary has been invested, and remains invested, outside British India. His contention, which is also the contention of the Commissioner of Income tax in the reference, is, that this income must be treated as having been brought into British India by

reason of the way in which it was dealt with in the accounts of the Company. In the accounts of the Company the total profits were shown at a sum of eight lacs and odd rupees and in those total profits is undoubtedly included the interest on foreign investments. Then the profits are dealt with by a declaration of dividend, which, in the words of the directors, "will absorb" an amount of nearly six lacs of rupees leaving a sum of over two lacs of rupees to be carried forward to the next year's account. Now, the contention of the Commissioner is that inasmuch as this interest on foreign investments was included in the profits of the company for the year and as these profits were applied largely in payment of a dividend in India, the foreign income must be treated as having been brought into India, because otherwise it could not have been applied in payment of the dividend in India. On the other hand it seems clear that if in fact this interest was not received in British India it could not have been applied towards payment of a dividend in British India. The explanation put forward by the assesses, which is not disputed by the Commissioner of Income tax or the Assistant Commissioner, is that the dividend was in fact paid by raising a loan on the security of the reserve fund which was available for payment of dividend and that in point of fact although this foreign interest was taken into account for the purpose of ascertaining the amount of profits and the sum which should be applied in payment of dividend, the actual sum was not used in payment of dividend.

The answer to the question raised really depends on the construction of Section 4 of the Indian Income tax Act, which provides that the Act shall apply to income, profits or gains accruing or arising or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British India. It is to be noticed that the profits which are to be deemed to be received are only those deemed to be received under the provisions of the Act. There are provisions in the Act, for example, in Section 7 (2), Section 11 (3) and Section 42 under which income not in fact received in British India is to be deemed to be received in British India, but those provisions do not cover the present case. What we have to determine is whether the foreign interest was received in British India. No doubt, foreign income may be received in British India in a variety of forms. Income need not be transmitted to British India in specie in the form in which it was actually received abroad. It may be transmitted by any method recognised in the commercial world as

appropriate for the transmission of money, and I think further, that it might be received in account, by means of cross entries. If, for example, it were shown that a sum representing income received abroad had been exchanged, by appropriate book entries, for an asset in India, and had then been applied as income in India, I should say that the foreign income had then been received in India. But so long as income is invested and remains invested outside British India, and the investments retain their character of interest received abroad I cannot see how the interest can be said to have been received in India. The mere fact that the amount of the income has been brought into account in ascertaining the profits for the year and has been taken into account also in determining the amount to be paid in dividend seems to me irrelevant unless it be proved that this actual income has been received in India and applied in payment of dividends, and that is not shown. The case seems to me to be covered in principle by the decision of the House of Lords in *Gresham Life Assurance Society v. Bishop* (1902) A.C. 287. The proviso to Section 4 (2) of the Indian Income-tax Act also supports this view. In my opinion, therefore, we must answer the question raised in the negative. The assessee should get their costs from the Commissioner of Income-tax taxed on the original side scale.

KANIA, J.—I agree. The short point for consideration is the construction of Section 4 of the Indian Income-tax Act. Under that section income from whatever source derived, accruing, arising or received in British India, or deemed under the provisions of the Act to accrue, arise or to be received in India, is liable to be taxed. The latter part of the section which consists of income deemed under the provisions of the Act to be received in India is not applicable here, because it is conceded that the present case does not cover that situation. The only question therefore is whether the income in question was received in India.

Before the Income-tax authorities the assessee company produced their accounts kept by Messrs. Coutts & Co., of investments and interest. Although those accounts are not included in the printed paper book, it is common ground, and now admitted by the learned Advocate-General, that the assessee company kept a separate account with Messrs. Coutts & Co., of their investments and interest thereon. Interest on that fund was again reinvested and retained either in the United Kingdom or America. It is therefore clear that the interest on those securities was not in fact remitted to India.

It was urged that from the report of the directors and the balance sheet of the company that foreign income should be considered or treated as received in British India. For this purpose the learned Advocate General relied only on two facts: That the interest earned on those foreign securities and retained by Messrs. Coutts & Co., was included in the total interest shown in the balance sheet. This does not go against the assessee, because the explanation to Section (4) clearly provides that the mere inclusion of such interest in the balance sheet does not make the amount, as received in British India.

The next fact relied upon was the statement in the directors' report that after taking into consideration the interest on those securities the total profit was determined and the dividend would absorb a certain amount. In my opinion the fallacy underlying this argument is that it is treated as if this profit was received in India. The report of the directors and the statements contained therein, in my opinion, do not amount to an admission that the foreign income was received in India. In considering the words "received in the United Kingdom" under the English Income-tax Act of 1842, it was further pointed out in *Gresham Life Assurance Society v. Bishop* (1902) A.C. 287 at page 297 that the fact of profits (shown in the account) having been distributed amongst shareholders of the company did not carry the case any further. Therefore the fact, that relying on the profits arrived at by including the interest earned on foreign investments, a dividend was paid to shareholders, did not make the interest on foreign investments as received in India.

I agree that the questions should be answered as stated by the learned Chief Justice.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

VIR BHAN BANSI LAL

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON, A.C.J., and DIN MUHAMMAD, J.

July 7, 1938.

PENALTY—TIME LIMIT FOR IMPOSITION—IMPOSITION AFTER TAX HAS BEEN PAID—LEGALITY—MEANING OF PAYABLE—INDIAN INCOME TAX ACT (XI OF 1922), SECTION 28,

Where notice under Sec. 28 of the Indian Income Tax Act for the imposition of penalty has been issued before the assessment order is made, a penalty under that section may be imposed on a date subsequent to the date of the assessment order and even after the income tax assessed has been paid by the assessee. The word 'payable' in the latter portion of the section means 'to which he has been assessed', whether the amount has been paid or not.

Obiter: It is desirable that the Legislature should remove the ambiguity that exists in the language of Section 28.

Civil Reference No. 8 of 1938.

Case stated under Section 66 (3) of the Income Tax Act (Act XI of 1922) as directed by their Lordships of the Lahore High Court in Civil Miscellaneous No. 257 of 1937 in respect of the imposition of penalty under Section 28 of the Act for the assessment year 1931-32 on Messrs. Vir Bhan-Bansi Lal, Amritsar :—

STATEMENT OF CASE.

"Statement of Facts.—The assessee is a Hindu Undivided family deriving income from money-lending, *Kachi Ahrat*, business in cattle etc., and house property. In the original assessment for 1931-32 the Income-tax Officer computed a loss of Rs. 2,548 and therefore no demand was created. Subsequently action under Section 34 was taken for 1931-32 which resulted in an assessment under Section 23 (4) on a total income of Rs. 71,926, and this assessment was upheld by their Lordships in their judgment dated 24th January 1936 in case No. 71 of 1935. The assessment under Section 23 (4) read with Section 34 was completed on 14th June, 1934, and in the last paragraph of the assessment note the Income Tax Officer made the following remarks :—

"A reference to the details in the assessment note above clearly shows that the assessee has concealed the particulars of his income and deliberately furnished inaccurate particulars of his income and has thereby returned it below its real amount and he has made a statement in a verification mentioned in Section 22 which is false and which he knew or believed to be false and did not believe to be true and has thus made himself liable to action under Section 28 or 52 of the Income Tax Act. The action if any to be taken under these sections will be decided and taken separately."

In the Order Sheet of the Miscellaneous file for 1931-32 there is the following order recorded by the Income Tax Officer on 13th,

June, 1934 :—" 32, 13-6-34. Issue notice on the file *re* action under Section 28 or 52".

Against this entry in the Order sheet there is a note of the office, dated 14th June 1934, in the margin showing that the notice was issued on 14th June, 1934. The notice was written on 13th June 1934 and from the endorsement at the bottom of it and the note by the clerk of the Income Tax Office, dated 14th June, 1934, it appears that a copy of the notice was sent to the assessee on 14th June, 1934 by post as well as under postal certificate. Copy of the notice with the endorsement of the office on it is Exhibit A. It will appear from the notice that the assessee was called upon to attend the Income Tax Officer on 18th June, 1934 to show cause as to why he should not be prosecuted under Section 52 of the Income Tax Act or why a penalty should not be levied under Section 28 of the Income Tax Act. Another copy of the notice was made over to the office peon on 13th June, 1934 for service on the assessee but on 14th June, 1934 the peon returned the notice unserved with the following report :—" It is submitted that I went twice to the shop of the assessee yesterday (13th June, 1934). Again I went to-day in the morning but Vir Bhan was not found. His *Mukhtar* was present. He refused to sign. Therefore this report is submitted".

14th June 1934

Sd. Mohammad Shah,
Peon,

On 18th June, 1934 another attempt was made for service of the notice through the office peon, but the office peon again returned the notice unserved with the following report :—

" It is submitted that for the service of the notice upon the assessee I went to his shop so many times. I also went to his house two or three times. The assessee intentionally hides himself. Therefore this report is submitted".

18th June, 1934.

Sd. Mohammad Shah,
Peon.

On receipt of this report of the peon, the Income-tax Officer passed the following order on 18th June, 1934 :—

" Assessee to be summoned now for the 8rd July, 1934. To be served through the Inspector S. Sham Singh."

18th June, 1938.

Sd. R. L. Bhalla.

In accordance with this order of the Income tax Officer the Inspector was able to serve the notice with the amended date on

Vir Bhan on 18th June, 1934. In the meantime, however, Vir Bhan appeared before the Income tax Officer on 18th June 1934 and filed an objection against the proposed prosecution under Section 52 or imposition of penalty under Section 28. Copy of the objection is Exhibit B. It will appear from Exhibit B that Vir Bhan acknowledged receipt of the notice, dated 13th June, 1934 (Exhibit A) and that it was in pursuance of that notice that he filed the objection on 18th June, 1934. It is, therefore, clear that copy of the notice, dated 13th June, 1934 (Exhibit A) which was sent by post on 14th June 1934 was duly served upon the assessee by the Post Office, because otherwise the assessee had no reasons to appear on 18th June, 1934 and to show cause, seeing that the notice sent through the peon fixing 18th June, 1934 could not be served on the assessee up to 18th June, 1934. On 18th June, 1934 the Income Tax Officer also noted in the Order Sheet that the notice served by post was received. On 18th June, 1934, the Income Tax Officer also recorded the statement of Vir Bhan in which Vir Bhan said that he had nothing to add to what was contained in the written objection (Exhibit B).

2. The proceedings under Section 28 were kept pending and no order was passed as the alternative proposal of starting prosecution under Section 52 was under contemplation. Ultimately it was decided to drop the proposal of starting prosecution under Section 52. After this the proceeding under Section 28 which was kept pending all this time was further continued and on 24th April, 1936 the Income Tax Officer in continuation of the notice Exhibit A and the assessee's objection to Exhibit B, wrote to the assessee giving him a further opportunity to explain on 27th April, 1936 why penalty under Section 28 should not be imposed. The Income Tax Officer's letter, dated 24th April, 1936 is Exhibit C. On 27th April, 1936 in response to Exhibit C the assessee appeared through authorised agents before the Income Tax Officer and filed a written objection of which the following portion is relevant to the present issue :—

"The provisions of Section 28 can only come into operation during the "course of the assessment proceedings". Under Section 28, when penalty is imposed no prosecution proceedings can be taken for the same offence. It is for the Income Tax Authorities to make choice to bring into operation Section 28 or 52 of the Income Tax Act.

"After serving the notice, dated 13th June, 1936 (sic. 34) we have been called upon to show cause several times why proceedings

under Section 52 may not be taken against us. After several hearings proceedings under Section 52 have been dropped. In the meantime the assessment has been finished, appeal before the Assistant Commissioner and the Commissioner have been finished and lastly reference in the High Court has also come to an end. Now there are no proceedings pending with your goodselves regarding the assessment of the year 1931-32. Hence no action can be taken under Section 28 at this stage."

The Income Tax Officer heard the assessee's authorised representatives and examined the accounts again with reference to the explanations given by the authorised representatives in their arguments on 27th April, 1936, 28th April, 1936 and 29th April, 1936. On 2nd May, 1936 the Income Tax Officer passed an order under Section 28 imposing a penalty of Rs. 2,500. Copy of the portion of the order under Section 28 which is relevant to the present issue is Exhibit D. The assessee filed an appeal in which one of the grounds taken by him was "that no penalty proceedings could be taken after taking prosecution proceedings and when no assessment proceedings are pending". The Assistant Commissioner rejected this ground and the relevant portion of the appellate order is Exhibit E. Being dissatisfied with the appellate order the assessee filed an application under Section 66 (2) before my predecessor in which only some questions were formulated by the assessee, the question relevant to the present issue being "Whether in view of the fact that no proceedings under Section 28 were initiated on notice, dated 13th June, 1934, under Sections 28-52 served after 16th April, 1936 (sic. 34) and a fresh notice under Section 28 was issued on 23 October, 1935, when no proceedings were pending before the Income Tax Officer was not the Income Tax Officer *functus officio* and the proceedings under Section 28 *ultra vires* and without jurisdiction?" My predecessor rejected the application under Section 66 (2) and the relevant portion of his order, dated 7th October, 1936, is Exhibit F. Against my predecessor's order the assessee filed an application under Section 66 (3) (Exhibit G) before the Hon'ble High Court.

3. **Question referred.**—As directed by their Lordships in their order dated 13th December, 1937 (Exhibit H) in Civil Miscellaneous No. 257 of 1937 I refer the following question to their Lordships for decision :—

"Whether, although notice issued under Section 28 of the Act a day before the assessment order was made by the Income Tax Officer that Officer had power on a date subsequent to the

date of the assessment order, to impose a penalty under Section 28?"

Opinion of the Commissioner.—I have already pointed out that two copies of the notice dated 13th June, 1934 (Exhibit A) were issued for service. One copy was issued by post under postal certificate on 14th June 1934, and that was served on the assessee before 18th June 1934, the date fixed for showing cause. The actual date of service is, however, not known. The copy of the notice issued for service through the peon could not be served up to the 18th June, 1934, and on 18th June, 1934, very likely after the assessee had appeared before the Income Tax Officer the Inspector served a copy of the notice with the date of showing cause altered from 18th June, 1934 to 3rd July, 1934. Section 28 (1) of the Income Tax Act runs thus:—

"If the Income Tax Officer, the Assistant Commissioner or the Commissioner, in the course of any proceedings under this Act, is satisfied that an assessee has concealed the particulars of his income or has deliberately furnished inaccurate particulars of such income, and has thereby returned it below its real amount, he may direct that the assessee shall, in addition to the income tax payable by him, pay by way of penalty a sum not exceeding the amount of the income tax which would have been avoided if the income so returned by the assessee had been accepted as the correct income."

I submit that the first portion of Section 28 (1) beginning with the words "If the Income Tax Officer" and ending with the words "its real amount" defines when the Income Tax Officer or the Assistant Commissioner or the Commissioner can have jurisdiction to start proceedings under Section 28. The second portion which begins with the words "he may direct" and ends with the words "correct income" is the operative portion by virtue of which penalty can be inflicted after the first portion of the section has conferred jurisdiction on any of the officers mentioned therein. Grammatically the clause "in the course of any proceedings under this Act" appears in the first portion of the section and qualifies the verb "is satisfied" occurring in the first portion and has got no connection with the verb "may direct" in the second portion of the section. There is no time limit prescribed in the operative portion of the section by virtue of which the order imposing penalty of Rs. 2,500 was passed on 2nd May, 1936. I therefore submit that if the Income Tax Officer started the proceedings under Section 28 within time under the first portion of Section 28 (1) he

could pass the order imposing the penalty by virtue of the second portion of the section at any time. I may here point out that under the Income Tax Act there is no time limit for *completing* any proceedings which have been started in time under the Act, except under Section 35. It has now to be seen whether the Income Tax Officer started the proceedings under Section 28 in time within the meaning of the first portion of Section 28 (1). The assessment was completed on 14th June, 1934, and I have already quoted the last paragraph of the assessment note showing that in the course of the assessment proceedings the Income Tax Officer was satisfied that the assessee had concealed the particulars of his income and had deliberately furnished inaccurate particulars of his income and had thereby returned it below its real amount. In my opinion as soon as the Income Tax Officer had recorded the above fact in the assessment note dated 14th June, 1934, the first portion of Section 28 (1) conferred upon him the jurisdiction to continue the proceedings up to the imposition of the penalty without any time limit. Even earlier than 14th June, 1934 the proceedings under Section 28 had been started by the Income Tax Officer ordering on 13th June, 1934 that issue of notice under Sections 28/52, his signing the notice on 13th June, 1934 and the notice having been made over to the peon on 13th June, 1934 for service. If the non-service of the notice made over to the peon on 13th June, 1934 is considered to be any defect, I would point out that the notice which was sent by post on 14th June, 1934 and duly served by the Post Office removed any such defect.

For reasons stated above, I submit that the question should be answered in the affirmative."

C. L. Aggarwal, for the Assesseees.

J. N. Aggarwal, for the Commissioner.

JUDGMENT.

This is a case stated by the Commissioner on the following question formulated by this Court under sub-section (3) of Section 66 of the Indian Income Tax Act, 1922 :

"Whether, although notice issued under Section 28 of the Act a day before the assessment order was made by the Income Tax Officer, that Officer had power on a date subsequent to the date of the assessment order to impose a penalty under Section 28?"

The Commissioner contends that if once the Income Tax Officer starts proceedings under sub-section (1) of Section 28 within

the time prescribed there, he is empowered to make an order imposing a penalty under that sub-section even after the assessment order has been finally made and the tax been paid. On behalf of the assessee on the other hand it is urged that the Income Tax Officer becomes *functus officio* after making the assessment order and that inasmuch as he is required to be satisfied and make his direction in the course of any proceedings under the Act, he can only impose a penalty at the time when he makes the assessment and not at any subsequent period, especially after the tax as assessed has already been paid.

Unfortunately sub-section (1) of Section 28 is not happily worded and it is on account of want of clearness and precision in the language employed there that this dispute has arisen. That sub-section runs as follows :

“If the Income Tax Officer, the Assistant Commissioner or the Commissioner, in the course of any proceedings under this Act, is satisfied that an assessee has concealed the particulars of his income or has deliberately furnished inaccurate particulars of such income, and has thereby returned it below its real amount, he may direct that the assessee shall, in addition to the income tax payable by him, pay by way of penalty a sum not exceeding the amount of the income tax which would have been avoided if the income so returned by the assessee had been accepted as the correct income.”

As regards the limit of time when the Income Tax authorities are to be satisfied that any concealment has taken place or any particulars have been deliberately furnished inaccurate there appears to be no ambiguity and consequently no dispute. It is common ground that this satisfaction must take place in the course of any proceedings relating to the assessee, whatever the nature of those proceedings may be. The difficulty arises only in the matter of determining the point of time when the direction as contemplated by that sub-section is to be given. The assessee draws our attention particularly to the word “payable” as used in the sub-section and urges that by the use of this term the Legislature intended to restrict the exercise of the power conferred by this sub-section to the period when the liability of an assessee was determined and before the tax was paid and consequently this power cannot be exercised at a time when the tax has already been paid. The language as used in this section may be susceptible of this interpretation but it cannot be denied that the interpretation sought to be put upon it by the Commissioner is not impossible.

Considering that the former interpretation may lead to absurd results and that the latter is more in consonance with reason we have no hesitation in adopting the interpretation suggested by the Commissioner. There is no magic in the word "payable." It is true that it has been frequently used in the Act to denote 'liability to assessment', but had the word "paid" been used here as suggested by the assessee, it might have led to many complications in the matter of imposing penalties under sub-Section (1). In our view, the words, "payable by him" without any unnecessary straining of language can be taken to mean "to which he has been assessed" whether the amount has been paid or not, and taken in that light it cannot be urged that the order contemplated by Sub-sec. (1) cannot be made after the assessment order has been made, and the tax has been paid. We see no justification for holding that the order should either be contemporaneous or simultaneous with the order of assessment. Neither is it intended to delay the assessment proceedings in order to enable the Income Tax Officer to make up his mind as to the imposition of penalty nor is the order of imposition to be accelerated merely to synchronise it with the assessment order. To insist on the order of penalty being simultaneous with the order of assessment is to ask for a physical impossibility : one is bound to precede or follow the other and if once it is conceded that the order of penalty may be made after the order of assessment has been made, there is nothing in the Act which would tend to restrict that period in any manner.

There is no direct authority in support of our view but we consider that the construction proposed by us to be put upon the sub-section is the only reasonable construction that can be put both in the interests of the Department and of the assessee. The Department will not be compelled to delay the assessment proceedings with a view to determine whether to prosecute an assessee under Section 52. or to impose a penalty on him under sub-section (1) of Section 28 or to do neither and the assessee will not run the risk of being victimised by any rash or hasty order.

We accordingly answer the question propounded above in the affirmative. We, however, in the circumstances of the case, leave the parties to bear their own costs.

We further draw the attention of the Commissioner to the desirability of approaching the Central Legislature with a view to remove the ambiguity that exists in the language of Section 28 as the matter of amending the Income Tax Act is already on the *tapis*.

Reference answered accordingly.

[IN THE LAHORE HIGH COURT.]

SHEIK MUBARAK ALI

v.

COMMISSIONER OF INCOME TAX, PUNJAB.

SIR JAMES ADDISON, A. C. J., and DIN MOHAMMAD, J.

June 27, 1938.

RE-ASSESSMENT—ESTIMATE OF SALES AT CERTAIN FIGURE—DISCOVERY OF CONCEALMENT—FRESH ASSESSMENT ON REVISED ESTIMATE OF SALES AT HIGHER FIGURE—LEGALITY—INDIAN INCOME TAX ACT (XI of 1922), Secs. 34, 23 (4).

In the return submitted by the assessee (a bookseller) for the year 1934-35 he showed his sales at Rs. 12,699 and charged profit at 10 per cent. The Income Tax Officer accepted the figure of sales but charged profit at 24 per cent. In the assessment for the year 1935-36, when the assessee's accounts were scrutinised more carefully it was found that the assessee had invested Rs. 8,000 in 1932 and Rs. 25,000 in 1933 though he had only returned an income of Rs. 900 for 1931-32, Rs. 1,081 in 1932-33, and Rs. 237 in 1933-34. Judging from the reputation of the assessee, his investments and his habitual concealment of income the Income tax Officer made a fresh assessment for the year 1934-35 under Section 34 raising the sales to Rs. 40,000 :

Held, that the revised assessment under Sec. 34 could not be held in the circumstances to be arbitrary or capricious and was not illegal.

Commissioner of Income Tax, Burma v. U Lu Nyo [1933] (1933 I.T.R. 373) distinguished.

Cases referred to :

COMMISSIONER OF INCOME TAX, U. P. & C. P. v. LAXMI NABAIN BADRIDAS [1937] (1937 I.T.R. 179; I.L.R. 1937 Nag. 191).

COMMISSIONER OF INCOME TAX, BOMBAY v. KHEMCHAND RAMDAS [1938] (1938 I.T.R. 414; A.I.R. 1938 P.C. 175).

COMMISSIONER OF INCOME TAX, BURMA v. U LU NYO [1933] (1933 I.T.R. 373; 12 Rang. 118).

WILLIAMS v. GRUNDY [1934] (1934 I.T.R. 236).

Case stated under Section 66 (3) of Indian Income Tax Act (XI of 1922) as ordered by their Lordships of the Lahore High Court in Civil Miscellaneous No. 337 of 1937, in respect of the assessment for the year 1934-35, under Section 23 (3) read with Section 34 of the same Act.

“Statement of facts.—The status of the assessee is individual and he derives income from property and sale of books. The accounting period for the assessment of 1935 is 1933-34. In the original assessment for 1934-35 the assessee returned a loss of Rs. 329 worked out as below :

Cr.		Rs.	Dr.	Rs.
Sales Rs. 12,699. Profit 10 per cent.	}	...	1,300	Expenses 2,175
Rent from house property.		...	546	
Net loss ,,		...	329	
Total		...	2,175	2,175

The assessee did not prepare any trading account or profit and loss account. In his books the assessee showed purchases during the accounting period at Rs. 7,475. There were no details of the V. P. P. sales in the *Rokar*. The assessee had not separated the sales of his own publications from general sales. The Income Tax Officer also found that the assessee had purchased two properties worth Rs. 8,000 and Rs. 21,000 in his own name and his wife's name, respectively, and had spent about Rs. 4,000 in re-building his business premises. It appears that the property worth Rs. 8,000 was purchased on 19th November, 1932, and that worth Rs. 21,000 was purchased on 1st April 1933. Under the circumstances and in view of the fact that the margin of profits in this business is very high, the Income Tax Officer did not accept the gross profit of Rs. 1,300 calculated by the assessee but estimated it at Rs. 3,048, 24 per cent. on the entire sales of Rs. 12,000. The total income from all sources was worked out to be Rs. 3,323. Copy of the original assessment order for 1934-35 is Exhibit A. The assessee filed an appeal against this order which was rejected. Copy of the appellate order is Exhibit B. In connection with the assessment for 1935-36 books were more thoroughly examined and it was found that sales were not shown in full and accounts were

manipulated. Accordingly proceedings under Section 34 were started for 1934-35 and as there was no goods account and the books produced were not supported by vouchers and as the assessee had built up considerable house property, the Income Tax Officer did not accept the assessee's sale version of Rs. 12,700 and estimated it at Rs. 40,000 as the result of his personal enquiries and worked out gross profit at Rs. 10,000, 25 per cent. Copy of the assessment order for 1934-35 under Section 23 (3) read with Section 34 is Exhibit C. The assessee filed an appeal which was rejected. Copy of the grounds of appeal is Exhibit D and copy of the appellate order is Exhibit E. Being dissatisfied with the appellate order the assessee filed an application under Section 66 (2) (Exhibit F) before my predecessor which was rejected by him by his order dated 30th December, 1936 (Exhibit G). The assessee then filed an application under Section 66 (3) (Exhibit H) before the Hon'ble High Court.

Questions referred.—As directed by their Lordships in their order dated 9th December 1937 (Exhibit I) in Civil Miscellaneous No. 337 of 1937 I refer the following questions for the decision of the Hon'ble High Court :—

(1) "Whether there was any material or evidence for the enhancement under Section 34 by increasing sales from Rs. 12,700 to Rs. 44,000 ? and

(2) Whether in the circumstances of the case, a part of the income, profits and gains from the sale of books in the accounting year 1933-34 can be said to have escaped assessment within the meaning of Section 34 at the time of the original assessment for the year 1934-35."

Opinion of the Commissioner.—(Question 1)—At the time of the hearing before me I wanted to see whether the assessee had any stock account and whether he had shown the opening stock on 1st April, 1933, anywhere in the books. No stock account could be shown and the opening stock on the 1st April, 1933, was nowhere recorded in the books of the assessee. Cash memos of sales are not also available. Under the circumstances and in view of the facts that the assessee had not separated the sales of his own publications from general sales and that no details of the V. P. P. sales had been kept in the *Rokar* it is not possible to check the accuracy of the sale version of the assessee. In the original assessment for 1934-35 the Income Tax Officer was therefore wrong in

not putting the assessee to the proof of his sale version and in accepting it without scrutiny. The first assessment of the assessee was for the year 1931-32. For 1931-32 the total income assessed was Rs. 3,092 against Rs. 900 returned by the assessee : for 1932-33 it was assessed at Rs. 3,071 against Rs. 1,031 returned by the assessee ; for 1933-34 it was assessed at Rs. 2,110 against Rs. 237 returned by the assessee. It is therefore clear that the assessee is in the habit of concealing sales, otherwise he could not have accumulated Rs. 29,000 which he invested in house property. I submit that this fact alone with the result of the personal enquiries made by the Income-tax Officer justifies the estimate of sales at Rs. 40,000 against Rs. 21,700 shown by the assessee. The answer to this question should therefore be in the affirmative.

4. Question (2).—The assessee seems to have relied upon the decision of the Rangoon High Court in *U Lu Nyo's Case* and in *De Brothers' Case* in which the decision in *U Lu Nyo's case* has been followed. In *U Lu Nyo's case*, in the original assessment the quantity sold was estimated to be 787 maunds and the net profit was estimated at Rs. 30 per maund. In the subsequent assessment under Section 34 the quantity sold was estimated to be 666 maunds and the net profit was estimated at Rs. 60 per maund. In our case in the original assessment for 1934-35 the sales were not at all estimated but were accepted at the figure shown by the assessee without proper scrutiny. In the subsequent assessment under Section 34 against the assessee's version of Rs. 12,700 an estimate of Rs. 40,000 was substituted based on materials which I have already discussed. It cannot therefore be said that so far as the sales are concerned one estimate was substituted for another. What was done in this case was really that an estimate was substituted in the latter assessment for the assessee's version which was accepted without proper scrutiny in the former assessment. I therefore, submit that so far as the estimate of sales is concerned, the facts are different from those in the case of *U Lu Nyo* and of *De Brothers* and therefore those rulings will not apply.

The next point is about the rates. In the original assessment the rate of 24 per cent was applied whereas in the subsequent assessment the rate of 25 per cent was applied on the entire estimated sales of Rs. 40,000. So far as the sales amounting to Rs. 12,700 are concerned, it must be conceded that they are included in the subsequent estimate of Rs. 40,000. Therefore the

increase in rate by 1 per cent on Rs. 12,700 is not justified in the light of the ruling in *U Lu Nyo's Case*. As pointed out by my predecessor in his order, dated 30th December, 1936 (Exhibit C) the relief on this account in tax will be about Rs. 60. I am quite prepared to give this relief although it may be small. As regards the rate of 25 per cent applied on the balance of Rs. 27,300 the decision in *U Lu Nyo's Case* does not apply. I, therefore, submit that the answer to question (2) should be in the affirmative with this proviso that the increase of rate by 1 per cent on Rs. 12,700 in the assessment under Section 34 is not justified.

Kirpa Ram, for the Assessee.

J. N. Aggarwal, for the Commissioner.

JUDGMENT.

SIR JAMES ADDISON, A. C. J.—On an application made by the assessee, we issued a mandamus to the Commissioner requiring him to state the case on the following two questions:—

(1) Whether there was any material or evidence for the enhancement under Section 34 by increasing sales from Rs. 12,700 to Rs. 40,000 ? and

(2) Whether, in the circumstances of the case, a part of the income, profits and gains from the sale of books in the accounting year 1933-34 can be said to have escaped assessment within the meaning of Section 34 at the time of the original assessment for the year 1934-35 ?

The material facts are these. The assessee is a bookseller and also owns some immovable property. In the return submitted by him for 1934-35, he showed his sales at Rs. 12,699 and charging profit at the rate of 10 per cent, he returned his total income assessable to income-tax from the sale of books at Rs. 1,300. To this he added Rs. 546 as rent from house property and debited the total amount with an expenditure of Rs. 2,175 thus claiming a loss of Rs. 329. The Income Tax Officer did not challenge the figure of sales but enhanced the rate of profit to 24 per cent. The assessee took an appeal from that order but it was dismissed.

In connection with the 1935-36 assessment, the Income Tax Officer scrutinised the assessee's accounts more carefully and came to the conclusion that the accounts could not be depended upon.

It transpired that the assessee had purchased immovable property worth Rs. 8,000 in his own name on the 19th November, 1932, again on the 1st April, 1933, he had purchased immovable property worth Rs. 21,000 in the name of his wife and had further spent Rs. 4,000 in renovating his business premises. It was obvious that these acquisitions could not be properly explained in face of the returns previously submitted by the assessee, inasmuch as in 1931-32 he had made a return of Rs. 900 only, in 1932-33 of Rs. 1,031 only and in 1933-34 of Rs. 237 only. The Income-tax Officer accordingly issued a notice to the assessee under Section 34 and eventually raised the figure of sales to Rs. 40,000 in which he was supported both by the Assistant Commissioner of Income-tax and the Commissioner.

The question is whether the estimate now arrived at by the Income Tax Authorities is based on any material. The leading authority on the subject as to what constitutes 'material' in such cases is the latest pronouncement of their Lordships of the Privy Council, in *Commissioner of Income Tax, Central and United Provinces v. Laxminarain Badridas* reported in I.L.R. 1937 Nag. 191. LORD RUSSELL OF KILLOWEN who delivered the judgment of their Lordships observed at pages 201 and 202 (1937 I.T.R. at pp. 180-181):

"The Officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly, or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessment of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate: and though there must necessarily be guess-work in the matter, it must be honest guess work. In that sense too the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to amount is final and subject to no appeal; but whose decision if it can be shown to have been arrived at without an honest exercise of judgment, may be revised or reviewed by the Commissioner under the powers conferred upon that official by Section 33."

In the present case the Income tax Authorities not only took into consideration the recent acquisitions made by the assessee but also the fact that since 1931-32 none of his returns was ever held to be genuine. In 1931-32, his estimate of Rs. 900 was raised to Rs. 3,092, in 1932-33 from 1,081 the estimate was raised to Rs. 3,751 and in 1933-34 his estimate of Rs. 237 was raised to Rs. 2,110. In the circumstances explained above, we are not in a position to say that the Income Tax Officer who formed the original estimate had no material or had acted "dishonestly or vindictively or capriciously" or that he did not "honestly believe the estimate arrived at by him to be a fair estimate of the proper figure of assessment". If the assessee considers that the estimate is far in excess of the actual income earned by him, the remedy lies in his own hands. He should try to be honest in his dealings with the Income Tax Authorities and keep accurate accounts of all the business done by him and if the Income Tax Authorities are satisfied that his accounts are reliable, we are sure that they will never resort to the 'best judgment' assessment in future. Counsel for the assessee relies on *Commissioner of Income Tax, Burma v. U Lu Nyo* in support of his contention that when once an estimate has been made, no second estimate can be made under Section 34, but even if the observations made in that case were correct, they do not govern the present case, as it proceeds on different facts. We accordingly answer question No. 1 in the affirmative. Question No. 2 need not detain us long. This matter is again concluded by authority. In a recent judgment reported as *Commissioner of Income Tax, Bombay v. Khemchand Ramdas*, (A.I.R. 1938 P.C. 175; 1938 I.T.R. 414) their Lordships of the Privy Council have held :

"When once a final assessment is arrived at, it cannot be reopened except in the circumstances detailed in Section 34 and Section 35 of the Act and within the time limited by those sections".

This evidently implies that even the 'best judgment' assessment can be reopened under Section 34. As to the circumstances in which a second assessment can be made although the first assessment had become final, reference may be made to 1934 I.T.R. 286 (*Williams v. Grundy*). It is true that the language of Section 125 of the English Act is different, but the governing principle is the same. In that case the Inspector of Taxes had accepted the contention of the assessee and made no assessment in respect of a certain item of income and sometime later

he reconsidered the facts and came to the conclusion that the income was taxable. FINLAY, J., held that the income could be taxed and that the act of the Inspector was not open to any legal objection.

Counsel for the assessee has drawn our attention to 6 I.T.R. 265 (*Mahaliram Ramjidas, In re*), where it has been held that in deciding whether income had escaped assessment, an Income Tax Officer must not act on suspicion or conjecture and must decide the question upon a fair and reasonable consideration of such information and materials as are available to him. This judgment, however, does not help the assessee in the least, inasmuch as no principles laid down there have been violated in this case. On the grounds stated above we answer this question too in the affirmative.

In the circumstances of the case, however, we leave the parties to bear their own costs before us.

Reference answered accordingly.

[IN THE PRIVY COUNCIL.]

BENGAL COAL CO., LTD.

v.

SRI JANARDAN KISHORE LAL SINGH DEO
AND ANOTHER.

LORD ROMER, SIR SHADI LAL and SIR GEORGE RANKIN.

June 28, 1937.

INCOME TAX—MINING LEASE—COVENANT MAKING LESSEE
LIABLE FOR ALL TAXES AND PUBLIC DEMANDS IMPOSED UPON
OR IN RESPECT OF THE MINES—WHETHER INCLUDES INCOME TAX
ON ROYALTIES RESERVED BY LEASE.

Income tax is not a tax imposed 'upon the mines or part thereof' in any sense relevant to the lessee's covenants in a mining lease. Even express words making the lessee liable for all public demands imposed upon the proprietors in respect of the mine would not bring income tax within the covenant.

Judgment of the Calcutta High Court in BENGAL COAL CO. v. JANARDAN KISHORE LAL SINGH DEO [1936 I.T.R. 392] affirmed.

P. C. Appeal (No. 69 of 1937) from a judgment of the Calcutta High Court reported as 1936 I.T.R. 392.

L. M. Jopling, for the Appellants.

A. M. Dunne, K. C. and *J. M. Parikh* and *B. Parikh*, for the Respondents.

JUDGMENT

SIR GEORGE RANKIN.—By a mining lease dated 4th March, 1915, the Plaintiffs demised to the Bengal Coal Company, Ltd. (Defendants) therein called "the lessees", the mines, beds, veins and seams of coal in Mousa Poidih in the District of Burdwan for 30 years from 1st April, 1915. The first of the lessees' covenants contained in Part VII of the schedule to the lease was in the following terms:—

"The lessees shall pay the royalty and royalties reserved by this lease at the time and in the manner above appointed in that behalf and shall also pay and discharge all taxes, rates, assessments and impositions whatsoever being in the nature of public demands which shall from time to time be charged, assessed or imposed upon the said mines or any part thereof by authority of the Government of India or the said Local Government or otherwise except demand for land revenue and shall also pay interest at the rate of 12 per cent. per annum on all arrears of such royalty or royalties from the due date thereof."

By their plaint filed in the Court of the Subordinate Judge at Asansol on the 21st June, 1929, the Plaintiffs claimed to be entitled under this covenant to decree against the Defendants for a sum of Rs. 2,095-8-0 together with certain interest. The claim is for re-imbursement in respect of certain cesses or taxes for which the Plaintiffs became liable between the years 1923-1929 (inclusive) and which they have paid. These public demands are three in number—namely, (1) Road and Public Works Cess under the Cess Act, 1880 (Bengal Act IX of 1880) (2) expenses charged to the plaintiff under cl. (b) of sub-sec. (1) of Section 10 of the Bengal Mining Settlements Act, 1912 (Bengal Act II of 1912); (3) Income-tax upon royalties reserved by the lease.

The Subordinate Judge gave the plaintiff a decree in respect of all three heads of claim but disallowed the claim for interest. On appeal by the Defendants the District Judge of Burdwan (7th December, 1932) disallowed the claim in respect of income tax but upheld the trial Court's decision as to the other two heads of claim. Both sides having appealed to the High Court, NASIM ALI and EDGLAY, JJ., affirmed the decision of the District Judge by decrees dated 24th March, 1939. Two appeals to His Majesty have

been brought pursuant to certificates granted by the High Court under clause (c) of Section 109, Civil Procedure Code, and they have been consolidated. The defendants by their appeal dispute that they are liable in respect of Road and Public Works Cess or the charge under the Mining Settlements Act. The plaintiffs appeal against the disallowance of their claim in respect of income tax. No question as to interest arises: nor is it contended that there is any reason why the covenant should not have effect according to its tenor.

Learned Counsel for the Defendants have drawn attention to the fact that the words of the covenant—charged, assessed or imposed upon the said mines or any part thereof—are not accompanied by phrases (to be found in books of conveyancing precedents) designed to enlarge their scope by making express mention of demands imposed in respect of the demised premises or in respect of the royalties reserved by the lease. *Allum v. Dickinson* has been cited to show that the fact that a charge can be enforced against the premises does not in all circumstances make it a charge imposed on the premises and the observations of MATHEW, L.J., in *Foulger v. Arding* have been referred to as showing that unless there be express mention of demands imposed on the owner in respect of the premises, such a demand is not within the covenant.

The words "taxes, rates, assessments and impositions whatsoever" are followed by the words "charged, assessed or imposed upon the said mines"—a variety of phrase which is intended to avoid restricting the covenant to cases in which the demand is in the strictest sense "charged upon the land." The phrases are to be taken in their ordinary and natural meaning. In *Payne v. Esdaille*, the House of Lords had to interpret the phrase in a Statute of Limitations "periodical sums of money charged upon or payable out of any land except moduses or compositions belong to a spiritual or eleemosynary corporation sole." As moduses were incapable of being charged on land in the sense of being payable out of land or realisable by remedy against the land itself the phrase "charged upon" was interpreted in a wider sense and as having no technical meaning. It was considered by LORD HERSCHELL that the *prima facie* and most common meaning would make it applicable only to those cases in which there was some remedy against the land itself, but that it might well be used to describe a burden imposed upon land if a payment has to be made in respect of land and the land can only be enjoyed subject to the liability for that payment, Lord Macnaghten observed:—

"The liability to the payment falls upon the occupier or taker for the time being by reason of his occupation. The land carries the liability as a burthen from taker to taker. Beyond all doubt that liability subtracts something from the profitable enjoyment of the land; it must be taken into account on the occasion of a sale, a mortgage, or a lease. An intending purchaser would give so much less purchase money; an intending mortgagee would strike the amount off the rental in calculating the value of the proposed security and an intending lessee would offer so much less rent. It seems to me that according to the ordinary understanding of mankind that is a charge upon land, which cannot be dissociated from the land and which charges the occupier in respect of the land."

The particular illustration of an intending lessee does not here apply owing to the special nature of the demand in question, but the other illustrations (intending purchaser, intending mortgagee) are applicable and add point to the circumstance that a remedy is given against the land itself. Their Lordships see no features in the present case rendering these considerations insufficient to attract the operation of the covenant and are of opinion that the High Court was right in holding that this part of the plaintiffs' claim is well founded.

Income-tax is in a very different position, as intending purchasers or mortgagees of the lessors' interest would appreciate. It is not a tax imposed upon the mines in any sense relevant to the lessees' covenants in a mining lease. Indeed, express words referring to public demands imposed upon the proprietors in respect of the mine would not have brought income-tax within the covenant. It may be true that the suggestion that the covenant extends to income-tax in respect of the plaintiffs' royalties would not in 1915 seem so unreasonable as it would after the Indian Income-tax Acts of 1918 and 1922 had graduated the tax according to the amount of the assessee's total income. But a general tax on the income of all persons with exceptions for smaller incomes is plainly outside the scope of the covenant.

The result is that in their Lordships' opinion both appeals should be dismissed. They will humbly advise His Majesty accordingly. There will be no order for costs.

Solicitors; *Sanderson Lee & Co.*, for the Appellants.

Stanley, Johnson & Allen for the Respondents.

[IN THE HOUSE OF LORDS].

HUGHES (INSPECTOR OF TAXES)

v.

BANK OF NEW ZEALAND.

LORD ATKIN, LORD THANKERTON, LORD RUSSELL OF
KILLOWEN, LORD MACMILLAN and LORD MAUGHAM.

March 4, 1938.

BUSINESS EXPENDITURE—EXPENDITURE INCURRED IN RESPECT OF INVESTMENTS WHICH PRODUCE NON-TAXABLE INCOME—WHETHER ALLOWABLE—EXEMPTION OF INTEREST ON INDIA STOCK, WAR LOAN & COLONIAL SECURITIES—ENGLISH INCOME-TAX ACT, 1918, SEC. 46; SCH. C, R. 2 (d); SCH. D, MIS. RULES, r. 7 (2).

The Bank of New Zealand which had a branch office in London was assessed on the profits arising from trade exercised at the London branch. The Bank claimed that certain items namely, (i) interest on 5 per cent. War Loan, (ii) interest on Government of India Stock, (iii) interest on Grand Trunk Pacific Railway and Auckland Specific Power Board were exempt from tax and also claimed that the cost of obtaining the money used in these four securities, so far as it was not part of the Bank's capital, should be deducted as expenditure incurred for the purposes of the trade: Held, affirming the judgment of the Court of Appeal, that the items of interest in question were absolutely exempt from income-tax, and they could not be taxed as trading profits under Case I of Schedule D. Held further, that though these interest items were exempt from tax, as the investments in question were part of the business of the bank's trade, the expense connected with them was wholly and exclusively laid out for the purposes of the trade and should be deducted in computing the profits to be charged.

Per LORD THANKERTON: Expenditure in the course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense.

Appeal from a judgment of the Court of Appeal. The judgment appealed from is reported at 1938 I.T.R. p. 541.

The Attorney-General (Sir Donald Somervell, K.C.), and Reginald P. Hills for the Appellant.

A. M. Latter, K. C. and J. S. Scrimgeour for the Respondents.

LORD ATKIN: My Lords, in this case I have had an opportunity of reading the opinion which is about to be delivered by my noble and learned friend Lord Thankerton. I agree with it, and find it unnecessary to add anything.

LORD THANKERTON: My Lords, the respondent bank, which admittedly resides in New Zealand, and is not resident or ordinarily resident in the United Kingdom, has a branch office in London. It is admittedly assessable to income-tax under the Income-tax Act, 1918, Case I, Schedule D, on the profits arising from the trade exercised at the London branch, and the present appeal relates to an assessment to income-tax in the sum of £ 94,448 for the year ending April 5, 1929, made upon it by the additional commissioners of income-tax for the city of London under Case I, in respect of these profits.

The following statement shows, in summary form, the material receipts and expenses of the London branch for the year ending March 31, 1928 upon which the assessment was based, as adjusted for income-tax purposes by the additional commissioners:—

Dr.	£	Cr.	£
Working expenses	41,070	Exchange and commis-	
Interest paid on deposits		sion (mainly, profit on	
and balances in London	19,312	exporter's bills pur-	
Rebates on bills receivable		chased)	90,600
which were immature		Loans to Banks and dis-	
on March 31, 1928	7,814	count houses	87,209
Commission and ex-		Interest on overdrawn	
change	86,482	accounts	25,558
Interest and expenses paid		Interest on dishonoured	
in New Zealand in res-		bills	2,122
pect of money borrow-		Discounts on Treasury	
ed in New Zealand, and		bills	68,037
used at the London		Interest on War Loan	
branch	112,868	3½ per cent.	6,048
(Note—This item inclu-		Interest on War Loan	
des £41,262 in respect		5 per cent.	75,621

Dr.	£	Cr.	£
of money borrowed in New Zealand and used in the purchase of the following assets of the London Branch:—		Interest on India 3 per cent.	1,500
War Loan 5 per cent.		Interest on Grant Trunk Pacific Railway	412
India 3 per cent.		Interest on Auckland Electric Power Board	1,028
Grant Trunk Pacific Railway.		Profit on sale of securities	10,714
Auckland Electric Power Board).		Exchange adjustment	14,730
Balance profit	116,028		
	<u>£333,569</u>		<u>£333,569</u>

The respondent bank appealed against the assessment, and maintained that, under certain statutory exemptions, the following four credit items should be excluded from the account:

	£
1. Interest on War Loan 5 per cent.	75,621
2. Interest on India 3 per cent.	1,500
3. Interest on Grant Trunk Pacific Railway	412
4. Interest on Auckland Electric Power Board	1,028
	<u>£ 78,556</u>

The Crown disputed the respondents' contentions, but maintained that if these items, or any of them, fell to be excluded, the proportion of the debit item of £ 112,868 for interest and expenses which was attributable to the cost of obtaining the money used in earning the item or items so excluded should also be excluded, so that only the net profit derived should be excluded from the trading account. As stated above, the proportion attributable to the four credit items sought to be excluded is £ 41,262, which consists of the cost of obtaining from New Zealand the money used in these four securities, so far as it is not part of the bank's capital, and takes into account, not only the average rate of interest paid on deposits in New Zealand, and the cost of issuing notes there, but also an appropriate proportion of the general expenses incurred by the bank there.

The special commissioners upheld the respondents' contentions and excluded the four credit items from the account, and rejected the appellant's contention, on that footing, for exclusion of the debit item of £ 112,868 to the extent of £41,262. In accordance with this decision, the assessable profit was reduced from £ 116,023 by the amount of the four credit items (£78,556), to £37,467. On appeal to the King's Bench Division, LAWRENCE, J., affirmed the determination of the special commissioners, and his judgment was affirmed, on appeal, by the Court of Appeal, against whose judgment the present appeal is taken.

The statutory provisions on which the respondents base their claim for the exclusion of the items are as follows :

1. As regards the War loan interest, the Income Tax Act, 1918, Section 46, which provides :

"(1) Where the Treasury have before the commencement of this Act issued or may thereafter issue any securities which they have power to issue for the purpose of raising any money or any loan, with a condition that the interest thereon shall not be liable to tax or super tax, so long as it is shown, in manner directed by the Treasury, that the securities are in the beneficial ownership of persons who are not ordinarily resident in the United Kingdom, the interest on securities issued with such a condition shall be exempt accordingly".

2. As regards the India Government Stock, Schedule C, General Rules, r. 2, which provides :

"No tax shall be chargeable in respect of.....(d) the interest or dividends on any securities of a foreign state or a British possession which are payable in the United Kingdom, where it is proved to the satisfaction of the commissioners of inland revenue that the person owning the securities and entitled to the interest or dividends is not resident in the United Kingdom ; but, save as provided by this Act, no allowance shall be given or repayment be made in respect of the tax on the interest or dividends on the securities of any foreign state or any British possession which are payable in the United Kingdom:.....".

3. As regards the Grand Trunk Pacific and Auckland Electric Power stocks, the respondents contend that Schedule C, r. 2 (d), was made applicable to the interest on these stocks by Schedule D, Misc. Rules, r. 7 (2), which provides as follows :

"(1) Where (a) any interest.....payable out of or in respect of the stocks, funds, shares, or securities of any foreign or colonial company.....are intrusted to any person in the United Kingdom

for payment to any persons in the United Kingdom, the same shall be assessed and charged to tax under this schedule by the special commissioners ”.

“(2) All the provisions of Schedule C relating to the tax to be assessed and charged in respect of dividends payable out of any public revenue other than that of the United Kingdom, and intrusted to any person.....for payment to any persons in the United Kingdom, shall extend to the tax to be assessed and charged under this rule.”

As regards the War Loan, the Crown did not maintain their appeal. In this I think that the Crown were well-advised, for I agree with LORD WRIGHT, M.R., that their contention is contrary to the apparent meaning of the statutory provisions; originally contained in the Finance (No. 2) Act, 1915, Section 47, and would involve the very serious frustration of what the parties, taking the securities from time to time, might be assumed to have contemplated. It is necessary, however, to notice here an argument which the Crown put forward as applicable to all the four credit items in dispute—namely, that the provisions of Section 46 (1) of the Income-tax Act, and Schedule C, General Rules, r. 2 (d) merely exempted certain interest paid to persons not resident, or not ordinarily resident, in the United Kingdom from charge under Schedule C, or Schedule D, Case III, *qua* interest, and did not operate to exclude any trading receipts of a trade exercised in the United Kingdom from the computation of the profits of the trade for the purpose of assessment under Schedule D, Case I. This appears to have been the only argument submitted by the Crown as to the War Loan, but, despite their abandonment of it as regards the War Loan, they still maintained it as regards the remaining items before your Lordships.

My Lords, I have no difficulty in rejecting this contention. I agree with the courts below that, whether as interest or as a component part of the profits of a trade, the exemptions must equally apply.

The only question remaining as to the India Government Stock is whether Schedule C, General Rules, r. 2 (d), refers only to tax under Schedule C or is of general application. In my opinion, it is clearly not limited to Schedule C in its operation. The opening words of the rule do not limit it to no tax “under this schedule,” as is done in both r. 1 and r. 3, and it can hardly have been the intention to limit the exemption of the stock, dividends or interest of an accredited minister of any foreign state

under r. 2 (c). Equally, there seems to be no reason in so limiting r. (d). But, further, r. 2 (d) is a consolidation of the exemption conferred by the Finance Act, 1910, Section 71 (2), which was not limited to any particular schedule.

A more difficult question arises as to the Grand Trunk Pacific and Auckland Electric Power stocks—namely, as to the extent of the incorporation of the provisions of Schedule C by Schedule D, Misc. Rules, r. 7 (2), in view of the words :

“relating to the tax to be assessed and charged in respect of dividends payable out of any public revenue other than that of the United Kingdom, and intrusted to any person (other than the National Debt Commissioners or the Bank of England or the Bank of Ireland) for payment to any persons in the United Kingdom.”

The Crown maintain that the small group of nine rules under Schedule C, entitled “Rules as to interest, etc., with the payment of which persons other than the Bank of England, the Bank of Ireland, and the National Debt Commissioners are intrusted,” is alone incorporated by r. 7 (2). That group of rules relates to the payment of dividends payable out of the public revenue of Northern Ireland, or which are payable to any persons in the United Kingdom out of any public revenue other than that of the United Kingdom or of Northern Ireland. It is to be noticed that by Rule 9 of these rules the expression “dividends” is defined as including interest, annuities, dividends, and shares of annuities, and that in the eight preceding rules the word “dividends” is alone used. That group of rules is properly described as providing mere machinery. The respondents maintain that the language of Rule 7 (2) is apt to include every provision of Schedule C which, *mutatis mutandis*, is applicable to the dividends described in Rule 7 (2), and that among such provisions Schedule C, General Rules, Rule r. 2 (d), necessarily has a place.

My Lords, I feel the greatest difficulty in coming to any clear conclusion on the matter. I find the language of the sub-section of Rule 7 evasive and ambiguous. A slight alteration of the words could have clearly expressed either of the opposing constructions.

In the first place, I agree with the Court of Appeal in their acceptance of the argument of the Crown that the Finance Act, 1910, Section 71 (2), did not confer the exemption here claimed, and in their rejection of Mr. Latter's contention to the contrary. It follows that this exemption, if the respondents are right in their construction, is conferred for the first time by the Consolidation Act. The presumption against such a construction was rightly

recognised by the Court of Appeal, but they held that the language of the sub-section is sufficiently clear to overcome the presumption. They felt fortified in this view by the provisions of the Finance Act, 1924, Section 27, to which I will refer later.

The Crown's main contention is that Rule 7 is not a charging rule, but merely provides machinery for collection of tax, and that it would be out of place to find an exemption from tax in the rule. They claim, with some force, that the terminology of Rule 7 (2) substantially reproduces the heading of the small group of rules of Schedule C above referred to, noting incidentally that dividends are alone referred to, and that it is only in the small group that dividends are alone referred to, coupled with a definition clause.

The Court of Appeal held that Rule 7 (1) was a charging provision, and that the opening words of Rule 7 (2)—“All the provisions of Schedule C relating to the tax to be assessed and charged”—were general, and clearly included the general rules, *mutatis mutandis*. On the first point, I find it sufficient to say that, in my opinion, rules which are described as miscellaneous, and which contain, for instance, in Rule 2 undoubted exemption, afford a not inappropriate place for the grant of exemptions. It is on the wording of Rule 7 (2), however, that I feel doubt, for the words, following the opening words quoted above, have some resemblance to the heading of the small group of rules of Schedule C, taken along with the subject-matter of the group, as defined in Rule 1 of the group. The ambiguous nature of these words, so far as bearing on the point at issue, does not enable me to differ from the firm opinion of all three members of the Court of Appeal.

As already stated, however, the Court of Appeal, and in particular, LORD WRIGHT, M.R., and GREENE, L.J., found confirmation for their view of Rule 7 in the provisions of Section 27 of the Act of 1924, which provides a right of appeal from “the decision of the inland revenue commissioners” in certain specified cases. Section 41 of that Act provides that Part II, which includes Section 27, is to be construed together with the Income-tax Acts. Among the cases specified, the material provision (of the Finance Act, 1924, Section 27) is as follows:

“(3) This section applies to the following questions:—

(a) any question as to residence arising—

(i) under para (d) of Rule 2 of the General Rules applicable to Schedule C; or

(ii) under Rule 7 of the Miscellaneous Rules applicable to Schedule D in connection with a claim for repayment of income.

tax made to the commissioners of inland revenue by the person owning the stocks, funds, shares or securities and entitled to the income arising therefrom, or entitled to the annuities, pensions or other annual sums, as the case may be, and from whose income a deduction has been made on account of the income tax assessed and charged under the said rule”.

LORD WRIGHT, M. R., holds that head (ii) of sub-sect. (3) (c) treats Rule 7 as containing a provision in the terms set out, and holds that the terms set out are the exact terms to be found in Schedule C, General Rules, Rule 2 (d), and that, accordingly, they can only be found in Schedule D, Miscellaneous Rules, r. 7, if Rule 7 (2) has incorporated them, which is the conclusion at which he had already arrived. GREEN, L.J., expresses the same view and also lays stress on the use of the word “decision”, on the ground that that could only refer to a power of decision expressly conferred on the commissioners of inland revenue. I find myself unable to agree with this latter view. In my opinion, it may well refer to a refusal to concede the claim of the aggrieved person, which, prior to the Act, would have involved a petition of right—a procedure which the provision was apparently designed to obviate. On the first point expressed by the judges I do not feel so clear as to utilise this *ex post facto* legislation in the construction of the Act of 1918, but, again, I am not prepared to reverse, on appeal, the clear decision of the Court of Appeal. If the policy of the Crown is otherwise, it is for them to rectify the ambiguities by amending legislation. I am therefore of opinion that the appeal of the Crown fails on all the main questions.

There remains the alternative question as to reduction of the amount of the four credit items so to be excluded from the computation by a proportionate part of the debit item of £112,868, which has been agreed at £41,262. It is perhaps enough to say that the Crown are unable to point to any statutory provision in support of their contention, whereas the respondents find full justification for their resistance in the provisions of Schedule D, Cases I and II, Rule 3, which is as follows :

“ 3. In computing the amount of the profits or gains to be charged, no sum shall be deducted in respect of (a) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation ”.

In order to ascertain the authorised deductions, it is right to turn this into positive form. In this view, it seems to me to be

incontrovertible that, in the present case, the investments in question were part of the business of the respondents' trade, and that the expense connected with them was wholly or exclusively laid out for the purposes of the trade. Expenditure in course of the trade which is unremunerative is none the less a proper deduction, if wholly and exclusively made for the purposes of the trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense. I agree on this question with the decision of the courts below:

I am of opinion, accordingly, that the decision of the Court of Appeal should be affirmed, and that the appeal should be dismissed with costs.

LORD RUSSELL OF KILLOWEN:—My Lords, I agree.

LORD MACMILLAN:—My Lords, I also agree.

LORD MAUGHAM:—My Lords, I concur.

Appeal dismissed with costs.

Solicitors:—*Solicitor of Inland Revenue* for the Appellant
Linklaters & Paines for the Respondents.

[IN THE HOUSE OF LORDS].

PATON (FENTON'S TRUSTEE)

v.

INLAND REVENUE COMMISSIONERS

LORD ATKIN, LORD THANKERTON, LORD RUSSELL OF
KILLOWEN, LORD MACMILLAN and LORD MAUGHAM

January 24, 25, 27, March 4, 1938.

BANK INTEREST—INTEREST ADDED TO PRINCIPAL AT THE END OF EACH HALF-YEAR—WHOLE TREATED AS PRINCIPAL FOR NEXT HALF-YEAR—WHETHER AMOUNTS TO PAYMENT OF INTEREST.

In respect of a loan taken by a person from a bank, the bank added the interest accrued due on the loan every half year to the principal. No deduction of tax was made on the interest so added. The person against whom the interest was so adjusted claimed under Sec. 36 (1) of the Income Tax Act, 1918, for repayment of tax as if there was an actual payment of interest. The question arose as to whether such addition of interest to the principal amounted in law

to a repayment of interest in fact for the application of Section 36 (1) of the Act.

Held, affirming the decision of the Court of Appeal without going into the question whether tax had been deducted or not, and whether interest was paid out of profits or not, that no interest was in fact paid, that the method of accounting adopted by the Bank could not amount to a real payment of interest and that what the Act requires is that the sum due as interest shall have been actually discharged and not constructively paid.

Inland Revenue Commissioners v. Holder, 1932 A.C. 624; 16 T.C. 540 considered and distinguished.

Cases referred to:

ATTORNEY-GENERAL v. METROPOLITAN WATER BOARD [1928] (1 K.B. 833; 13 Tax Cas. 294; 97 L.J.K.B. 214; 138 L.T. 346).

BANK OF ENGLAND v. VAGLIANO BROTHERS [1891] (A.C. 107; 60 L.J.K.B. 145; 64 L.T. 353).

BEVAN, *Ex parte* [1803] (9 Ves. 223; 32 E.R. 588).

CLANCARTY (LORD) v. LATOUCHE [1810] (1 Ball & B. 429).

EATON v. BELL [1821] (5 B. & Ald. 34; 106 E.R. 1106).

INLAND REVENUE COMMISSIONERS v. HOLDER [1931] (2 K.B. 81; 100 L.J.K.B. 439; 145 L.T. 193) on appeal [1932] (16 Tax Cas. 540; 1932 A.C. 724).

Re JAUNCEY, BIRD v. ARNOLD [1926] (Ch. 471; 95 L.J. Ch. 377; 134 L.T. 728).

REDDIE v. WILLIAMSON [1863] (1 Macph. (Ct. of Sess.) 228).

Appeal from an order of the Court of Appeal (LORD WRIGHT, M.R., and ROMER, L. J., GREENE, L. J., dissenting) dated January 24, 1936, dismissing an appeal by the appellant from an order of FINLAY, J., dated March 25, 1935, whereby an appeal by the appellant upon a case stated by the commissioners for the special purposes of the Income Tax Acts was dismissed and the determination of the said commissioners affirmed.

A. M. Latter, K. C. and F. Heyworth Talbot, for the Appellant.

The Attorney-General (Sir Donald Somervell, K. C.) and Reginald P. Hills, for the Respondents.

LORD ATKIN:—My Lords, the question in this case arises on the claim of the appellant trustee under a deed of arrangement

executed in 1921 by Henry Fenton, to have repaid to him under the provisions of the Income Tax Act, 1918, Section 36, money which he says Fenton in the financial years ending April 5, 1921, and April 5, 1922, paid without deduction of tax out of profits and gains brought into charge as interest payable on an advance from Martins Bank. The commissioners say that Fenton did not pay the interest in the years in question, or at all, and that, if he did, he did not pay out of profits and gains brought into charge. FINLAY, J., and all the members of the Court of Appeal held themselves bound, as they were, by a previous decision of the Court of Appeal in *Inland Revenue Commissioners v. Holder*, to decide that the interest had been paid. They differed as to whether it had been paid out of profits and gains brought into charge, LORD WRIGHT, M.R., and ROMER, L.J., holding that it had not, GREENE, L.J., holding that it had. Counsel for the appellant have been heard on both points, but your Lordships did not find it necessary to decide the second point, and have not heard the Attorney-General upon it, and I express no opinion with regard to it. I am myself satisfied that the facts found by the special commissioners do not disclose any payment of the interest in respect of which the claim is made. The transaction with the bank is a simple one. In October, 1918, the bank advanced to Mr. Fenton the sum of £ 250,000 to complete the purchase of the share capital of a company in Labrador owning a large forest property. They took as security the shares in the company. The account is kept as an ordinary bank account, and is not styled a loan account. Throughout, there are no credit items, but the account is debited with cables to Canada, no doubt in connection with the transaction, and with small commissions to the Canadian bank, through which the transaction had been completed. At the end of the first half-year in December, 1918, the bank debit the account with charges £ 4,089 5s. 3d., which includes interest, and show a debit balance of £ 254,121 12s. 7d., made up of the original advance of £ 250,000, the amount of the cables and commission referred to, and the above sum for "charges." The account, balanced on December 23, 1918, begins the next half-year period on December 24, with a debit item: "to balance, £ 254,121 12s. 7d." There are no entries for the half-year until June 23, 1919, when charges £ 7,602 14s. 7d., are debited. The account is then balanced at £ 261,724 7s. 2d., and that balance is again brought down as the first debit item in the next half-year's account, which is balanced on December 31, 1919, at £ 270,349, after debiting charges

£8,613 7s. 7d., together with small sums for cables. We now come to the year 1920, in which the first year of charge in the present case begins. In the first half-year, the balance of £270,349 6s. 2d., is brought down, and, in addition to a few pounds for cables and payment to the Canadian bank on June 30, charges £9,999 16s. 3d., are debited, and the balance shown is £280,364 11s. 2d., I may set out the next two half-years' accounts:

1920		£	s.	d.		
June 30	To balance	280,364	11	2		
Dec. 31	Charges	11,306	15	5	Dec. 31, 1920	
					By balance	£ 291,671 6 7
		291,671	6	7		
Dec. 31	To balance	291,671	6	7		
1921						
June 4	Stp. & Fees					
	on					
	Equit. Charge	10	10	0		
June 24	Charges	11,291	6	1	June 30, 1921	
					By balance	£ 302,973 2 8
		302,973	2	8		
June 30	To balance	302,973	2	8		

The question is whether, when the charges are added to the existing indebtedness at the end of one half-year, and the whole sum brought down is a debit item at the beginning of the next half-year, so that interest is charged on the last half-year's interest, the charges have been paid. The ordinary man would, I think say that, so far from being paid, they are added to the ordinary indebtedness, because they are not paid and I can see no reason why the law should say anything different. It is obvious that the system adopted by banks, which seems to have been common practice in the time of LORD ELDON, L. C., is for the purpose of giving them compound interest without perhaps flaunting that fact before their customers.

It would seem that the members of the Court of Appeal in *Holder's* case considered that there was a line of authority which led them to the conclusion that, in these circumstances, the interest must in law be deemed to have been paid. I do not think that this is the result of the cases. *Ex parte Bevan* was a case of a petition in bankruptcy to be allowed to prove. One objection made was "that in settling accounts half-yearly interest had been turned

into principal." At that time the Usury Act, 1713 (12 Ann. Stat. 2, c. 16), was in force, which made illegal a contract to pay interest at a rate higher than 5 per cent. per annum. It does not appear from the report what was the nature of the debt or what were the occupations of either petitioner or debtor. LORD ELDON, L. C., said, at p. 224 :

"As to the question of compound interest, it is clear, you cannot *a priori* agree to let a man have money for twelve months, settling the balance at the end of six months; and that the interest shall carry interest for the subsequent six months: that is, you cannot contract for more than 5 per cent.: agreeing to forbear for six months. But, if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then stipulate, that you will forbear for six months upon those terms, that is legal."

There is here not a suggestion of payment. The only question for LORD ELDON, L. C., was the supposed illegality. An antecedent (*a priori*) agreement for half-yearly rests and interest upon the balance would be void, but, if one settles, *i.e.*, agrees, the balance at the end of six months, there is nothing to prevent one from making up a fresh start with the total debt, which no doubt includes interest, and agreeing to forbear from suing for the whole debt at a rate of interest meantime. In *Eaton v. Bell* the plaintiffs were bankers, and had held the defendant's account for a number of years, making up the accounts with half yearly rests, in pursuance of the practice above described. Both counsel and ABBOT, C. J., refer to the question as one of compound interest, and ABBOTT, C. J., says, at p. 40 :

".....it is now settled, that a party advancing money to another is entitled to charge interest, and at the end of every year, then to add the principal to the interest."

Later, he describes the process as converting the interest from time to time into capital. There is again not a word as to payment, and why it should be considered authority for the contention I do not know. I should have mentioned in order of date *Clancarty (Lord) v. Latouche*. There the plaintiffs had brought an action against the defendants, bankers of one Conolly whose executors the plaintiffs were, for an account of their testator's transactions. The plaintiffs had objected to the system of yearly rests. LORD MANNERS, L. C., directed yearly rests, and said, at p. 428 :

"for otherwise the defendants would not have legal interest for their money. If the interest were paid to them regularly at

the end of the year that interest in their hands would become capital and be invested; if it were not paid, they would not at the end of the second year receive legal interest upon the whole of the debt, due to them from Mr. Conolly unless that part of the debt, which consisted of interest, due at the end of the first year, was treated as capital; what is there in law or equity against this transaction?"

It will be observed that LORD MANNERS, L.C., so far from deeming the interest paid, considered it unpaid, and relied on that fact as justification for treating it as capital. Then comes the case of *Reddie v. Williamson* which has the high authority of LORD PRESIDENT INGLIS, then LORD JUSTICE-CLERK. In that case the dispute was between a co-obligant on a cash-credit bond given to a bank by the pursuer and his son, who was the customer of the bank. The bond was for £400 and interest. The account had been kept with yearly rests in accordance with the usual custom, and, at the date of the death of the customer, in 1850, showed, in accordance with the last balance of May 30, 1849, an indebtedness of £834. The question was whether, as the pursuer claimed, the amount due was £400, with interest from May 30, 1849, or whether, as the bank claimed, the amount was £400, with interest from January, 1844, the first date at which £400, principal became due on the account. The decision of the Second Division of the Court of Session was that the former view was right, interest on £400 having been extinguished from year to year by being added to principal in accordance with banking practice. The statement of the LORD JUSTICE-CLERK must be set out at some length after stating that the co-obligants are bound to pay up the interest at the end of the year, though the principal sum be not payable, he proceeds, at p. 237 :

"But if the bank instead of demanding from the co-obligants the interest due at the end of the year, choose, in concert with the obligant who is authorised to operate on the account, to avail themselves of their privilege of accumulating that interest with the capital, without any communication with the other obligants, they are dealing with the accounts, as far as these other obligants are concerned, in precisely the same way as if the leading obligant instead of paying the interest otherwise at the end of the year, had given the bank a cheque for the amount on the cash credit account with which the bank extinguished the interest, and then placed the amount of the cheque to the debit of the cash account as an ordinary draft. In this last case there can be no doubt, that the

credit would be additionally exhausted proportionally to the amount of the cheque given in payment of the interest; and if the full sum of the credit had been previously drawn out, the cheque for the interest would be an unauthorised overdraft, for which the other co-obligants could not be made answerable. But does it make any difference, that without a cheque the same amount is placed to the debit of the account and thereafter dealt with as a principal sum drawn out? I think not. The privilege of a banker to balance the account at the end of the year and accumulate the interest with the principal is founded on this plain ground of equity, that the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount, as a principal sum itself bearing interest".

As I understand this judgment, the LORD JUSTICE CLERK so far from saying that the interest is paid or is deemed to be paid, is saying that it is unpaid, and, because unpaid, the customer becomes debtor in the account as a principal sum. The position of the co-obligants, he says, in such a case, is like that which would arise if the interest had been charged by a cheque drawn on the account, when the principal sum would be increased by the amount of the cheque. A misfortune in the case is that LORD COWAN, misinterpreting, as I venture to think, the analogy adopted by the LORD JUSTICE CLERK goes further, and says, in a passage cited in *Holder's Case* by ROMER, L.J., that the true view is that the periodical interest must be held to have been paid when placed to the debit of the account as an additional advance by the bank for the convenience of the obligants. This seems to me contrary to what was said by the LORD JUSTICE CLERK and to be wrong. The simple fact is that the amount of interest accruing during the half-year is ascertained at the end of the half-year, and is added to the account as a debt in precisely the same position as the other debit items whether for money lent, the price of securities bought, commission or other source of debt. It takes its position as part of the whole debt due to the bank, and, as part of the whole debt, is in the next half-year chargeable with interest. It is no more paid than are other items of the total debt. This is the view, I think, clearly expressed by my noble and learned friend LORD RUSSELL of KILLOWEN, then RUSSELL, J., in *Re Jauncey, Bird v. Arnold*, where in a mortgage deed there was a provision that, whenever interest was in arrear for 21 days, it should be treated as an accretion to the capital moneys thereby secured, and should thenceforth bear interest. It was contended that, in those circumstances, interest

must be deemed to have been paid, so as to affect the meaning of the Real Property Limitation Acts. RUSSELL, J., said, at p. 476, that such a construction :

“would really amount to a travesty of the actual facts ; because in the case of such a provision as is contained in the present deed which enables the interest to be capitalised, the interest is not capitalised because it is in fact paid, but because it has in fact not been paid.”

I can add nothing to that succinct statement.

I think, therefore, that, in circumstances such as the present, there is no ground for holding that the interest in question was paid by Mr. Fenton, and therefore the interesting question as to whether, if paid, it was paid out of profits and gains brought into charge does not arise. I would add only that the question does not arise in this case as to whether, if the debit balance, including interest, is paid in the next or succeeding accounts, either in whole, or by a specific appropriation of a sum to the past interest, that is or is not a payment of interest for the purposes of the Income Tax Act. It may well be that interest is not as finally extinguished as some of the above decision seem to suggest, and I can see the hardships that would arise if, when the half-year's interest is ascertained only on December 31, and the whole balance is debited on January 1, the customer were debarred from income tax relief. That particular point does not arise here. For these reasons, I think that the appeal should be dismissed with costs here and below.

LORD THANKERTON—My Lords, my noble and learned friend LORD ATKIN has so fully expressed my views on the matter that I cannot usefully add anything, except that I would like to add this in particular, that, having had the privilege of reading the opinion about to be delivered by my noble and learned friend LORD MACMILLAN, I desire to express my concurrence in his analysis of the Scottish case of *Reddie v. Williamson*.

LORD RUSSELL OF KILLOWEN—My Lords, I am unable to see how, upon the facts of the present case, it can be said that there was any payment by Fenton of the interest in respect of which repayment of tax is claimed under the provisions of the Income Tax Act, 1918, Section 36 (1). The Court of Appeal, being bound by the authority of *Holder's case* necessarily held that Fenton had paid, or must be deemed to have paid the interest in question, but your Lordships are not so bound.

It is not, I think, too much to say that, in deciding as they did in *Holder's case* the Court of Appeal were largely, if not mainly, influenced by the views which they took of the basis and effect of the decision in the Scottish case of *Reddie v. Williamson*. As I understand the facts of that case, the pursuer had made himself liable as cautioner for what would be due by a customer on his current account with a bank up to a limit of £400, with interest. The account was kept with yearly rest, and, when the customer died, the balance last struck showed an indebtedness of over £800, which necessarily included a considerable amount of compound interest. The defender contended that the cautioner was liable for £400 and interest from the first date when the account showed a debit of £400. It was held that he was liable for only £400 with interest from the date of the balance last struck before the customer's death. The ground of the decision was that, although the bank could have recovered interest from the cautioner at the end of each year, they had chosen not to do so, but had accumulated it with capital; that they had thereby increased the credit given to the customer in exactly the same way as if they had taken from the customer a cheque in payment of the interest due and had debited his account with the amount thereof; that, if the full £400 had been previously drawn out, every such cheque for interest would have been an unauthorised overdraft, for which the cautioner could not have been made liable; and that it made no difference that, without the drawing of a cheque, the same amount was treated as a principal sum drawn out, and debited to the account.

My Lords, I think that, rightly considered, that decision does not rest on the view that the interest was paid in fact, or was deemed to be paid, but on the view that the liability of the cautioner could not be increased by treating the customer as a debtor for a principal sum in respect of interest which he had not paid.

It is not an authority which would justify us in holding that the requirements of Section 36 (1) are complied with where, as here, all that has happened is that, because the interest has not in fact been paid, the creditor has added the amount of the unpaid interest to the debtor's principal indebtedness. In my opinion interest which is so dealt with cannot be interest "paid to the bank", still less can it be interest "paid to the bank without deduction of tax out of profits or gains brought into charge" within the meaning of that section, I would dismiss the appeal.

LORD MACMILLAN—My Lords, two questions were argued on this appeal (i) whether certain interest on loans to Fenton by his

bankers was "paid" by him within the meaning of the Income-tax Act, 1918, Section 36 (1), and (ii) whether the interest, if paid, was paid "out of profits or gains brought into charge to tax" within the meaning of the same enactment.

The special commissioners before whom the matter came in the first instance, without deciding whether the interest in question had in fact been paid, held that, even if it had been paid

"it was not paid out of profits and gains charged to income-tax but had been paid out of further advances from the bank in question". On a case stated, FINLAY, J., and the Court of Appeal, in view of the previous decision of the Court of Appeal in *Inland Revenue Commissioners v. Holder* regarded themselves as bound to hold that the interest in question had been paid, or must be deemed to have been paid, within the statutory meaning. Dealing with the second question, FINLAY, J., held that the interest which he assumed to have been paid had not been paid out of profits or gains brought into charge to tax. So did the majority of the Court of Appeal (LORD WRIGHT, M. R., and ROMER, L. J., GREENE, L.J. dissenting). The decision of the special commissioners has thus so far been upheld.

The judgment of the Court of Appeal in *Holder's* case is not binding on your Lordships, for, although the case came on appeal to this House, and the judgment below was affirmed, it was here decided on a different point, and the question of the soundness of the view taken by the Court of Appeal as to what constituted payment within the meaning of the statute was expressly reserved by your Lordships.

The appellant, the trustee of the estate of Fenton under two deeds of arrangement, thus comes to this House with a decision in his favour on the first question and a decision against him on the second question. The Crown, as it is entitled to do, challenges the soundness of the decision on the first question, and thus in effect brings under review the principle of the decision of the Court of Appeal in *Holder's* case. If the Crown succeed in establishing that the interest in question was not "paid" within the statutory meaning, it will be unnecessary to proceed to consider the second question, for, if the interest was not paid at all, the question of whether it was paid out of profits or gains brought into charge to tax does not arise.

The facts of the case are simple. Fenton at all material times had loan accounts with the National Bank, Ltd., and the Halifax

Commercial Banking Co. Ltd., (Subsequently the Bank of Liverpool and Martins, Ltd.), on which he had drawn large sums. The practice of the banks was to debit Fenton's accounts at the close of each half-year with the interest accrued, and to carry the balance forward to the next half-year. As the balance carried forward included the amount of the interest accrued in the preceding half-year, the result was that the interest debited at the end of the next half year included interest on the interest accrued in the preceding half year. In effect, by thus adding interest to principal half-yearly, the banks charged Fenton with compound interest.

No question arises with regard to Fenton's loan account with the National Bank, Ltd., as to which the commissioners state that "the whole of the interest was paid and eventually the account was in credit". As regards the loan accounts with the Halifax Commercial Bank, Ltd., in each of the calendar years 1920 and 1921, when interest fell due half-yearly on June 30 and December, 31, Fenton did not make any payment to the Bank, and the Bank at the end of each half-year simply debited the accounts with the accrued interest and carried the balance forward, charging interest at the end of the succeeding half-year on the accumulated principal and interest, and so on.

The Income-tax Act, 1918, Section 36 (1), upon which the present controversy arises, provides as follows:—

"Where interest payable in the United Kingdom on an advance from a bank carrying on a *bona fide* banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest".

For each of the tax years to April 5, 1921, and April 5, 1922, Fenton claimed that the action of the bank in debiting with his consent to his loan accounts half-yearly the accrued interest, and in carrying forward the accumulated sum, constituted, as between him and the bank, payment at each half-yearly period of the interest then falling due. He accordingly maintained that in the tax year to April 5, 1921, he had in this way paid £27,076 10s. 10d. of interest to the bank, without deduction of tax, on the bank's advances to him. As, after allowing for deduction and repayments, he paid income-tax for the year to April 5, 1921, on £7,777, he claimed that the sum of £27,076 10s. 10d. of interest had to the extent of £7,777, been paid out of profits or gains brought into charge to

tax, and that he was accordingly entitled to repayment of tax on £7,777 under the section above-quoted. He submitted similar calculations for the fiscal year to April 5, 1922, bringing out a claim for repayment for that year of tax on £2,722.

My Lords, it is a condition of a claim for repayment of tax on bank interest under Section 36 (1) that the taxpayer shall have "paid" to his bank the interest in respect of which he claims repayment of tax. In my opinion, this means that the taxpayer must really, and not merely notionally, have paid the interest. There must be payment such as to discharge the debt. The payment must be a fact, not a fiction.

What justification can there be for holding that Fenton in the year to April 5, 1921 "paid" to the bank a sum of £7,777 in discharge *pro tanto* of the interest charges of £27,076 10s. 10d. which he incurred to them in that year? What happened was that Fenton did not pay the interest due by him at June 30 and December 31, 1920, and it was because he did *not* pay it that it was debited to his loan account on each half-yearly occasion and the accumulated sum carried forward to the next half-year. The effect of this method of accounting between Fenton and the bank, it is suggested, was that, when the interest was debited to the loan account, Fenton ceased to owe it to the bank *qua* interest, and it became transmuted into an addition to the principal loan. The transaction at each half-year, it was said, when analysed, involved the following steps: a demand by the bank for the interest due, a request by Fenton for a further advance to enable him to pay the interest, an agreement by the bank to make this further advance, and, finally, the application by Fenton of this further advance to the payment of the interest, with the result that Fenton was entitled to maintain that he had "paid" the interest.

My Lords, the origin of this agreeable fiction whereby debts are to be deemed to be paid without payment may be traced historically to the ingenuity of lenders in devising a method of obtaining compound interest without contravening the usury laws. It was illegal by an antecedent contract to stipulate for the payment of compound interest, but, in the words of LORD ELDON, L. C., in *Ex parte Bevan* at p. 224: " . . . if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then stipulate, that you will forbear for six months upon those terms, (i. e., that the interest shall carry interest for the subsequent six months) that is legal". On this principle it was held in *Eaton v. Bell* that bankers who, with

the knowledge of, and without objection by their customers, debited them with interest with half-yearly rests in accordance with their general practice did not offend against the usury laws. The method of dealing with loan accounts, which became common form among bankers, survived the abolition of the usury laws, and is well established as the ordinary usage prevailing between bankers and customers who borrow from them and do not pay the interest as it accrues.

It may well be that, as between a bank and its customer, this method of dealing may have the result that the accrued interest which the bank has, with the customers assent, added to the principal loan thereby ceases to be due or recoverable as interest, but becomes merged in the principal loan. But has it been "paid"? In *Holders Case* the Court of Appeal in holding that, on this method of accounting, the customer (in the words of ROMER, L. J., at page 100) "must be deemed to have paid each half-year the accruing interest by means of an advance made for that purpose by the bank" to the customer, were largely influenced by the views expressed by LORD PRESIDENT (then LORD JUSTICE-CLERK) INGLIS and LORD COWAN in the Scottish case of *Reddie v. Williamson*. The pursuer in that case was a party as cautioner to a cash credit bond whereby the British Linen Bank agreed to allow the pursuer's son credit upon current account to the amount of £400, and the pursuer bound himself to pay up to that amount whatever should be due upon the account when demanded, with the due and lawful interest of the same from the time of advance until repayment. The principal debtor died insolvent and, at the last balance, on May 30, 1849, before his death, the account was at debit to an amount exceeding £800, composed to a large extent of compound interest calculated with annual rests, according to what was described as "the invariable practice of bankers". The defender was the agent of the British Linen Bank at Kinross, and the pursuer in the action sued him for an accounting as his factor or agent, complaining, *inter alia*, that he had paid to the bank out of his funds, in settlement of his liability under the cash credit bond, more than was legally due. The defendant's contention was that the sum found due at the last balance before the death of the principal debtor was composed partly of principal and partly of interest, and that the pursuer was liable to the bank for :

"£400 of principal and in addition for all the interest that may have accrued on that sum for however long a period and

though the whole of it has from time to time been added to and accumulated with principal."

The court held that the utmost extent of the pursuer's liability was for: "£ 400 of principal with interest thereon from May 30, 1849, all previous claim for interest having been extinguished by its being converted into principal."

My Lords, I think it is important to have in mind the nature of the action, as I have described it, in reading the language employed by the LORD JUSTICE CLERK and LORD COWAN, to which so much weight was given by the Court of Appeal in *Holder's* case. The question was whether the debit items of accrued interest, which according to the practice of the bank, had been debited to the account at the end of each year, and on which interest was thereafter charged, were capital debts attributable to the £400, or retained their character of interest. There was no suggestion that the debits had been discharged by payment. The question was one of construction of the cash credit bond, to which the cautioner was a party, and it was held that the parties must have had in view that the account would be kept according to the invariable practice of bankers. It is true that, in explaining that practice, the LORD JUSTICE CLERK said, at p. 237, that the method pursued by the bank of accumulating the interest with the capital annually was the same: "as if the leading obligant, instead of paying the interest otherwise at the end of the year, had given the bank a cheque for the amount on the cash-credit account, with which the bank extinguished the interest, and then placed the amount of the cheque to the debit of the cash account as an ordinary draft."

He added later at p. 237: "the privilege of a banker to balance the account at the end of the year, and accumulate the interest with the principal, is founded on this plain ground of equity, that the interest ought then to be paid, and, because it is not paid, the debtor becomes thenceforth debtor in the amount, as a principal sum itself bearing interest."

LORD COWAN said in less precise language, at p. 240: "By being carried into the account each year, and converted into principal, the interest was paid to the bank, and could not afterwards be revived as interest to suit their convenience or profit."

It may well be that, in a question between a bank and its customer, and equally between a bank and its customer's cautioner, the interest accruing annually may, by the sanctioned method of

accounting, cease to be interest when it is accumulated with the principal, so that the bank can thereafter no longer sue for the interest as interest. Your Lordships have not had the advantage of hearing the views of any representative of banking interest, and I should not wish anything that I say now to be taken as affecting any questions which may arise as between banks and their customers. It is manifest, however, that it is only by a legal fiction that the interest in such cases as the present can be said to have been paid. After, as before, the striking of the balance, the same sum remains due, no longer, it may be, as interest, but still due as part of the principal debt. In construing the extent of the cautioner's liability under the cash credit bond, the court would appear to have been well-founded in their view that the bank's own method of accounting, assented to by the principal debtor, and recognised as ordinary practice, precluded any claim for past interest as interest prior to the last balance. The cautioner was liable for whatever was drawn upon the cash credit account up to £400, and the unpaid interest was debited in account just like the ordinary drafts upon it, and became part of the principal debtor's capital indebtedness, for which the cautioner was liable up to £400, with interest subsequent to the last balance.

It is quite a different matter, however, when the question is as to whether the interest in such a case has been "paid" within the meaning of Section 36 of the Income Tax Act. In my opinion the phrases which I have quoted from the opinions of the LORD JUSTICE-CLERK and LORD COWAN were used in an entirely different context, and to apply them to the present question would be to misapply them. As I have already said, what the Income Tax requires as the condition of repayment of tax on interest is that the sum due as interest shall have been actually discharged, not merely constructively paid. To warrant repayment of tax, there must have been a real payment of tax and a real payment of interest without deduction of tax.

It is right to notice the point on which GREENE, L.J., laid stress, in his judgment—namely, that the purpose of Sections 36, presumably to avoid the double exaction of tax. I take it to be the case that a bank, in making up its return of profits or gains, brings into account the accrued interest on its loan accounts, whether paid or unpaid and accumulated, with the result that the unpaid and accumulated interest becomes a factor in computing the balance of its profits or gains on which, if a credit balance is shown, tax is paid. Indeed, it is, by the proviso to Section 36, a

condition of repayment of tax on interest that the interest be brought into account in the recipient's income-tax return, and in the present case we were asked to assume that this had been done. Nevertheless, the fact that the banks treat the accrued and accumulated interest in this fashion as an item of income in their income-tax accounts does not, in my opinion, necessarily lead to the view that the customer has paid this interest within the statutory meaning. At worst, the result may be that Section 36 affords only an imperfect remedy against double taxation. Indeed, the relief given in the matter of tax on interest by Section 36 is conferred only in the case of interest paid to certain specified types of lenders, and there are, of course, many instances where money which A pays out of his taxed income to B, is charged again with income tax in the hands of B.

The mischief of double taxation occurs where the same income is twice charged with tax. Where a person pays his current obligations out of his income, the money paid in the general case becomes the income in turn of the recipient, and the incomes of the payer and payee may both be taxed without double taxation in the proper sense. Section 36, in giving relief in certain cases of payment of interest, qualifies this general principle in these instances, and various explanations, none of them entirely satisfactory, have been suggested as to the principle on which the relief is given. One suggestion has been that the bank customer, in paying interest to the bank, is sharing or distributing one income as between himself and the bank, and that, accordingly, one income should bear only one tax. I do not find this convincing. Whatever may be the justification for treating the payment of interest in certain cases in this special fashion, it may well be, as so often happens in income-tax legislation, that what has been enacted does not completely achieve what was intended. At any rate, I am satisfied that Section 36 (1) does not cover the present case, whether it truly involves double taxation in the strict sense or not.

My Lords, if your Lordships are in agreement with me, it becomes unnecessary to consider the second question, and your Lordships are once more deprived of an opportunity of considering the true meaning of payment "out of profits or gains brought into charge" in relation to the case of *A.-G. v. Metropolitan Water Board*, on which topic the judges of the Court of Appeal have said much that is interesting and important. I concur in the motion that the appeal be dismissed with costs.

LORD MAUGHAM—My Lords, it is unnecessary to repeat the circumstances in which this appeal comes before your Lordships since they have been amply stated. Indeed, but for the fact that we have been invited to overrule one of the grounds for the decision of the Court of Appeal—namely, the case of *Inland Revenue Commissioners v. Holder* should have added nothing to the opinions of my noble and learned friends LORD ATKIN, LORD RUSSELL OF KILLOWEN, and LORD MACMILLAN.

In *Holder's Case* as in the present one, the question arose as to whether a taxpayer was entitled to repayment of tax under the Income Tax Act, 1918, Section 36 (1), which is in the following terms: "Where interest payable in the United Kingdom on an advance from a bank carrying on a *bona fide* banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest."

Section 36 (2) provides for similar relief: "on the like proof (in the case of advances from a person) *bona fide* carrying on business as a member of a stock exchange in the United Kingdom (or a person) *bona fide* carrying on the business, of a discount house in the United Kingdom."

Sub-section (1) corresponds with the Finance Act, 1915, Section 22, sub-section (2) with the Finance Act, 1917, Section 25. It will be remembered that the well-known and ancient rule, now rule 21 of the All Schedule Rules (resembling in some respects rule 19), applies to "payment of any interest of money, annuity or other annual payment charged with tax, etc." It provided that the interest-payer should deduct the amount of the tax and account for the same to the commissioners. There was originally no such right in the case of short loans (including overdrafts) from banks; in such cases, interest had to be paid without deduction. The right to recoupment was not given by the legislature till 1915, and it is said, was then conferred in order to facilitate during the War the raising of money on short loan from banks for the purpose of subscribing to government issues.

Under Section 36 the interest must be (i) paid to the bank without deduction of tax, and (ii) so paid out of profits or gains brought into charge to tax. The bank's customer is then to be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest,

In *Holder's Case*, as in the present, nothing was actually paid by the customer in respect of the relevant advance or advances, either for principal or interest. In accordance with the usual practice of bankers in this country, the system adopted by the bank was that each half-year the accrued interest was added to the amount advanced (including therein any interest previously added to the original amount), and the total sum was carried forward into the next half-year as one capitalised sum. This is a mere matter of entries in the books of the bank, and the result is to give the bank compound interest on the amount due. According to the authorities, the customer could object, but at the risk of being called upon to pay the amount due from him. It is not quite clear that his acquiescence in the account being kept on such a basis can be inferred simply from his receipt of a single pass-book or other account and his return of it without comment. Something may turn upon the other circumstances of the case, and acquiescence might doubtless be inferred from a course of business: *Bank of England v. Vagliano Brothers*, at pp. 116, 128. The question, however, arises, assuming the entries in the bank books to have been made with the assent of the customer, as to whether he has paid the interest each half-year to the bank.

In *Holder's Case* the Court of Appeal, relying on several cases which were dealing with the position as between the bank and the customer, held that the latter must be deemed to have paid the accruing interest half-yearly to the bank by means of advances made for that purpose by the bank to the customer. Those cases have been carefully considered by your Lordships, and I shall serve no useful purpose by making a further criticism or explanation of them. In particular, I agree that there is nothing in the cases which can lead us to the conclusion that the customer has paid the interest in the circumstances we are considering.

I venture to add some reasons on the construction of the section which have led me to the conclusion that something more than book entries made by the bank would be required to satisfy the Section. In the first place, I would observe that the legislature must be taken in 1915 to have been fully conversant with the usual practice of banks in the United Kingdom in relation to short loans and overdrafts. Unless that practice were departed from, there would always be a payment of interest by the customer—that is, either an actual payment or an apparent payment by an entry in the account. Yet the section takes care to provide that the facts must be proved to the satisfaction of the special

commissioners. Sub-section (2) requires "the like proof" of payment in the case of members of a stock exchange in the United Kingdom, yet it would seem reasonable to suppose that in such a case actual payment is required.

Next, it is difficult to see why payment of interest by the customer is required as a condition precedent to his right to repayment of tax unless the payment has actually been made in some shape or form. The requirement seems to have been borrowed and adapted from rule 21, or rather from its earlier form in the Customs and Inland Revenue Act, 1818, Section 24 (3). The legislature may well have thought that, if the customer never in fact paid the interest—*e.g.*, if he became wholly insolvent—he ought not to have a claim to repayment of tax on the interest, even if the interest were to be brought into account by the bank in the statement delivered to the commissioners. If the practice of bankers is to be sufficient to prove a payment, I cannot understand why the Finance Act, 1915, Section 22, was framed as it was.

Finally, it is to be noted that the payment is expressed to be "out of profits or gains brought into charge to tax." Without attempting to explain this somewhat cryptic phrase, it is, I think, reasonably clear that it imports such a payment by an exercise of volition on the part of the payer, and that it points in the direction of something more than could be established by the presumption of an advance by the bank, applied *volens volens*, so far as the customer is concerned, in discharge of accrued interest due by him.

My Lords, these reasons, as well as those stated by my noble and learned friends, which I will not stay to repeat, have led me to the conclusion that *Holder's Case* cannot be supported so far as it decided that the customer must be taken to have paid the interest on the advance due by him by means of further periodical advances made for that purpose. If this is correct, it must follow that the present appeal must fail, since one of the conditions on which the taxpayer is entitled to repayment of tax—namely, payment of interest to the bank—has not been satisfied. I therefore concur in the proposed motion.

Appeal dismissed.

Solicitors; *Blundell, Baker & Co.*, agents for *Mumfords & Gordons, Bradford* for the appellant: *Solicitor of Inland Revenue* for the respondents.

[IN THE RANGOON HIGH COURT].

MA HLA MRA KHINE v. MA HLA KRA PRU.

MOSLEY and DUNKLEY, JJ.

December 21, 1937.

INCOME-TAX RETURNS—ADMISSIBILITY OF COPIES—COURT HAS NO POWER TO ORDER PARTY TO OBTAIN COPIES OF HIS RETURNS AND STATEMENTS—INCOME TAX ACT (XI OF 1922), SEC. 54—CIVIL PROCEDURE CODE (ACT V OF 1908), O. 11, r. 14.

The object of Section 54, Income Tax Act, is to make income-tax returns confidential as between the assessee and the Income-tax Department, and against the whole world, except for certain limited purposes provided by the section itself, and it would clearly be an evasion of the prohibition contained in the section were the defendant in a court of law entitled to force the plaintiff to obtain and furnish any information from the Income-tax Officer against his interest which the defendant was unable to obtain for himself. Where such copies are obtained by the defendant, they are inadmissible in evidence unless the plaintiff himself wants their retention. Such copies do not come within the provisions of Section 76 of the Evidence Act.

Cases referred to :

ANWAR ALI v. TAFOZAL AHMED (2 R. 301; 84 Ind. Cas. 437; A.I.R. 1925 Rang. 84).

COLLECTOR OF JAUNPUR v. JAMNA PRASAD (44 A. 360; 66 Ind. Cas. 171; A.I.R. 1922 All. 37; 20 A.L.J. 140).

JAKARIA v. HAJI CASIM (1 B. 496).

JADOBRAM DEY v. BULLORAM DEY (26 C. 281).

MAUNG THA NYO & Co. v. MA UN MA PRU (7 R. 296; 119 Ind. Cas. 742; A.I.R. 1929 Rang. 260).

VENKATACHELLA CHETTIAR v. SAMPATHU CHETTIAR (32 M. 62; 1 Ind. Cas. 705).

Civil Revision No. 142 of 1937 against an order of the Assistant District Court, Akyab, dated May 10, 1937.

Tun Aung, for the Applicant.

Sein Tun Aung, for the Respondent.

MOSLEY, J.—This is an application in revision by the plaintiff in suit No. 2 of 1936 of the Assistant District Court of Akyab, Ma Hla Mra Khine, trading under the name of U Maung Tha Nyo

and Company, against an order of the Court made on the application of defendant respondent No. 9, Ma Hla Kra Pru, that the plaintiff be ordered, under the provisions of Order XI, Rule 14, Civil Procedure Code to obtain certified copies from the Income-tax Officer of an assessment of U Maung Tha Nyo and Company for the years 1927-28 and 1928-29 and also of the statement of the plaintiff's agent made before the Income-tax Officer for the assessment of 1927-28. The present suit is one by the plaintiff on a mortgage bond in favour of U Maung Tha Nyo and Company executed by defendants Nos. 1 and 2, the mortgagors. Defendants Nos. 3 to 8 are the legal representatives of a person who bought the mortgaged properties in execution of a simple money decree obtained by him against the mortgagors and defendant No. 9, and present respondent is added as a subsequent purchaser of the properties in suit from defendants Nos. 3 to 8. The application by the respondent was made on the ground mentioned in her written statement as well as in the application that the plaintiff was not the sole proprietress of the firm of U Maung Tha Nyo and Company that it was a partnership firm consisting of the plaintiff and ten other partners (her children), and that the plaintiff had not the sole right to sue.

There was a previous suit between the parties in 1927 (it would not appear from the records in this Court that the present respondent was a party there), the appeal from which to this Court is reported in *Maung Tha Nyo & Co. v. Ma Un Ma Pru*. It appears from the judgment in that case that the plaintiff had registered the business under the Burma Registration of Business Names Act erroneously under the names of her children as well as herself; she then sued the respondents in the name of the business, and her suit was dismissed on a technical ground that she had furnished wrong particulars in registration and, therefore, could not enforce her rights by suit under Section 5 of the Act. It was there said that she had, before judgment was passed in that appeal, effected a new registration of the business showing herself as the sole proprietress, and this is apparent from Ex. M in the present suit, which is a certified copy of the new registration which was effected on March 29, 1928. That being so, I totally fail to see how the information required by the respondent could be in any way relevant for the purposes of this suit. It is naively explained by the learned Advocate for the respondent that the information in question might be available for the purpose of prosecuting the plaintiff under Section 193, Indian Penal Code *vide*

Section 54, Proviso (a), Income Tax Act (XI of 1922). It may be remarked here that this application was made, and granted before any evidence whatever had been taken in the suit. The plaintiff had not been asked any questions on this subject even had it been relevant, and so the respondent's argument is that this was a fishing application to supply materials to prosecute the plaintiff in case she might subsequently commit perjury. The learned Assistant District Judge remarked in his order that the only authority on this subject was *Jakaria v. Haji Casim*. The most cursory search in any commentary under the relevant provisions of the Evidence Act, Sections 123 and 126, would have revealed at least three later authorities *Jadobram Dey v. Bulloram Dey*, *Venkatachellā Chettiar v. Sampathu Chettiar* and *Collector of Jaunpur v. Jamna Prasad*. These cases were decided under the Income Tax Act of 1886, where Rule 16 issued under Section 38 of that Act was as follows :

"All public servants are forbidden to make public or disclose, except for the purpose of the working of Act II of 1886, any information contained in documents delivered or produced with respect to assessments under Part 4 of the said Act and any public servant committing a breach of this rule shall be deemed to have committed an offence under Section 166, Indian Penal Code."

It was held there that the object of that provision was to secure the interest of those making the returns under the Act, and that that rule was not directed against their production in a Court of law. Section 54, Income Tax Act of 1922 is totally differently framed, and for a different purpose. It says that all particulars contained in any statement made, return furnished, or accounts or documents produced under the provisions of this Act, or in any evidence given in the course of any proceedings under this Act, other than proceedings under Chapter VIII, which refers to prosecutions for offences, or in any record of any assessment, proceeding, etc., shall be treated as confidential, and, notwithstanding anything contained in the Evidence Act, 1872, no Court shall, save as provided in this Act, be entitled to require any public servant to produce before it any such return, accounts, documents, etc., or to give evidence before it in respect thereof. This section, of course, in terms prohibits any Court from requiring such evidence to be given by the Income Tax Officer.

So far from no authority being available there is a ruling of this Court published in 1924—*Anwar Ali v. Tafozal Ahmed*—where it was explicitly held that income tax returns, being made

confidential by Section 54, Income Tax Act, and the disclosure of their contents, (by the public servant), being a punishable offence certified copies of such return do not come within the meaning of Sections 65, 74, 76 and 77, Evidence Act and are, therefore, not admissible in evidence. That was a case where the defendant (not the plaintiff) obtained from the Income-tax Officer copies of income tax returns made by the plaintiff. It was held that Section 76, Evidence Act, itself did not authorize the issue of certified copies of income tax returns to the defendant, as no private person (presumably other than the plaintiff) had the right to inspect them, and issue of these copies was clearly unlawful under Section 54, Income Tax Act. In the present case it is the defendant who seeks to obtain disclosure of these returns through the medium of the plaintiff, and, of course, exactly the same principle applies. It may be that the plaintiff has the right to obtain certified copies of these returns for her own purposes, but the object of Section 54 was to make these returns confidential as between the assessee and the Income-tax department, and against the whole world, except for certain limited purposes provided by the section itself. It would clearly be an evasion of the prohibition contained in the section were the defendant in a Court of law entitled to force the plaintiff to obtain and furnish any information from the Income-tax Office against her interest which the defendant was unable to obtain for herself. For these reasons it is clear that this application must be allowed.

I note that the respondent has already been successful in obtaining one document—a copy of an order of the Assistant Commissioner of Income tax in appeal, dated April 25, 1927, marked Exhibit 3. That document is inadmissible in evidence unless the plaintiff desires its retention. This application will be allowed, and the order of the Assistant District Court set aside with costs, which in view of the nature of the application sought to be revised, I assess at ten gold *mohurs*. This application has succeeded in delaying the suit for nearly a year. It is to be hoped that it will now be speedily disposed of.

DUNKLEY, J.—I agree.

Application allowed.

[IN THE COURT OF APPEAL.]

TRINIDAD PETROLEUM DEVELOPMENT CO.

v.

INLAND REVENUE COMMISSIONERS.

SLESSER, L.J., ROMER, L.J., GREENE, L.J.

November 15, 1943.

INCOME TAX AND SURTAX—INTEREST PAID UNDER DEDUCTION OF TAX—WHETHER PAYABLE WHOLLY OUT OF PROFITS OR GAINS BROUGHT INTO CHARGE—PROFITS OF PARTICULAR YEAR SET OFF AGAINST LOSSES OF FORMER YEARS—NO TAX ACTUALLY PAID FOR PARTICULAR YEAR—INCOME TAX ACT, 1918 (8 & 9 GEO. 5. C. 40), ALL SCHEDULES RULES, RR. 19, 21—FINANCE ACT, 1926 (16 & 17 GEO. 5, C. 22), Section 33 (1).

For the year 1933-34 a company paid interest amounting to £46,032 under deduction of tax. The company's net profits for the purposes of income tax for the year ending July 31, 1932, to which date its accounts in the year previous to 1933-34 were made up, were £69,908, but in previous year it had made losses, which it was entitled to carry forward under Section 33 of the Finance Act, 1926, and as those losses more than absorbed the net profits of £69,908, no tax was in fact paid for the year 1933-34: Held, that as the result of the losses of the previous years having been carried forward it was impossible to say that there was during the year of assessment any sum constituting profits brought into charge to tax. It followed, therefore, that the interest had not been paid out of profits or gains brought into charge, and consequently the tax thereon could not be retained under rule 19 (1) of the All Schedules Rules of the Income Tax Act, 1918, but the company was assessable to tax on that interest under rule 21.

Attorney-General v. Metropolitan Water Board [1927] (97 L.J.K.B. 214; [1928] 1 K.B. 833; 13 Tax Cas. 294) followed.

Decision of LAWRENCE, J., (105 L.J.K.B. 598; [1936] 2 K.B. 185) affirmed.

Cases referred to:

ATT.-GEN. v. LONDON COUNTY COUNCIL [1907] (76 L.J.K.B. 454; 1907 A.C. 181; 5 Tax Cas. 242).

ATT.-GEN. v. METROPOLITAN WATER BOARD [1927] (97 L.J.K.B. 214; 1928, 1 K.B. 833; 13 Tax Cas. 294).

CENTRAL LONDON RAILWAY *v.* INLAND REVENUE COMMISSIONERS [1936] (105 L.J.K.B. 513; 1937 A.C. 77; 20 Tax Cas. 102).

LUIPAARD'S VLEI ESTATE AND GOLD MINING CO. *v.* INLAND REVENUE COMMISSIONERS [1930] (99 L.J.K.B. 330; 1930, 1 K.B. 593; 15 Tax Cas. 211).

SUGDEN *v.* LEEDS CORPORATION [1913] (83 L.J.K.B. 840; 1914 A.C. 483; 6 Tax Cas. 211).

Appeal from a decision of LAWRENCE, J., on a case stated by the Commissioners for the Special Purposes of the Income Tax Acts.

At a meeting of the Commissioners on October 31, 1935, the Trinidad Petroleum Development Co., appealed against an assessment made upon it under rule 21 of the All Schedules Rules of the Income Tax Act, 1918, as amended by Section 26 of the Finance Act, 1927, for the year 1933-34 in the sum of £46,032 in respect of interest paid out of profits and gains not brought into charge.

For the year 1933-34 the company paid interest under deduction of tax to the British Controlled Oilfields, Ltd., as follows:

	£	s.	d.
July 31, 1933, on current	...	11,065	4 6
December 1, 1933, on debentures	...	26,586	3 9
December 31, 1933, on current account	...	8,380	12 9
		<hr/>	
	£ 46,032	1	0
		<hr/>	

The profits of the company as computed for purposes of income tax for the year to July 31, 1932, to which date its accounts in the year previous to 1933-34 had been made up, were ... £160,718

Less wear and tear brought forward

from previous years	...	£ 48,715	
Less wear and tear for 1933-34	...	42,095	
		<hr/>	90,810
			<hr/>
			£ 69,908
			<hr/>

The company had claimed under the Finance Act, 1926, S. 33 (1), to carry forward losses of £26,473 and £55,612 attributable to the years 1927-28 and 1928-29 respectively, and to set such losses off against profits on which it might be assessable under

Schedule D for subsequent years. The relief thus claimed fell under sub section 3 of the same section to be given to the extent of £ 69,908 against the assessment for 1933-34 as follows :

Assessable profits 1933-34		£ 69,901
Loss for 1927-28	... £ 26,472	
Loss for 1928-29	... 55,612	
	<hr/>	82,085

Balance loss (attributable to 1928-29) carried forward £ 12,177

On behalf of the company it was contended :

(1) That the amount of profits or gains on which the company was assessed under Schedule D for the year 1933-34 was £ 69,908.

(2) That the fact that the company had a right under Section 33 of the Finance Act, 1926, to have losses of previous years deducted from or set off against the amount of the profits on which it was assessed for the year 1933-34 did not prevent such profits from being brought into charge to tax.

(3) That £ 69,908 was the amount of the company's profits or gains brought into charge to income tax for the year 1933-34.

(4) That, as the company's profits or gains brought into charge to tax exceeded the amount of interest paid, such interest was wholly payable out of profits or gains brought into charge and was not assessable under rule 21.

On behalf of the Crown it was contended :

(1) That the interest in question came within rule 21 of All Schedules Rules of the Income Tax Act, 1918.

(2) That the profits and gains for 1933-34 against which losses had been set off by virtue of Section 33 of the Finance Act, 1926, were not profits and gains which had been brought into charge to tax for the purposes of rule 19 of those rules.

(3) That the assessment should be confirmed.

The Commissioners confirmed the assessment.

The company appealed.

LAWRENCE, J., confirmed the assessment (105 L.J.K.B. 598; [1936] 2 K.B. 185) and the company again appealed.

The relevant sections of the statutes referred to have been set out in the judgment of SLESSER, L.J.

Needham, K. C., and Scrimgeour, for the appellants.

The Solicitor-General (Sir Terence O'Connor, K. C.) and R. P. Hills, for the Crown.

The material parts of the sections and rules of the Income Tax Act, 1918, are set out in the judgments.

JUDGMENT.

SLESSER, L. J.—In this case a company, the Trinidad Petroleum Development Co., appeal against an assessment which has been made upon them under rule 21 of the General Rules All Schedules, Income Tax Act, 1918, as amended by Section 26 of the Finance Act, 1927, in the sum of £46,082 odd in respect of interest paid under deduction of tax to another company, the British Controlled Oilfields, Ltd. The question which has to be decided in this case is whether this payment comes under rule 21 or rule 19 of the General Rules to which I have referred. It is argued by counsel for the appellants that the proper view is that rule 19 applies to this case, which, so far as material, is as follows: (1) "Where any yearly interest of money, annuity, or any other annual payment is payable wholly out of profits or gains brought into charge to tax, no assessment shall be made upon the person entitled to such interest, annuity, or annual payment, but the whole of those profits or gains shall be assessed and charged with tax on the person liable to interest, annuity, or annual payment, without distinguishing the same, and the person liable to make such payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making such payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the said payment was accruing due". It will be observed that rule 19 (1) is dealing with a yearly interest of money payable wholly out of profits or gains brought into charge to tax, and the first question which has to be considered is the meaning of the words "brought into charge" in that connection. In my view, having regard to the decision of this Court in *Attorney General v. Metropolitan Water Board*, and to the opinion expressed by all the learned Judges in that case, to which I shall presently refer, it is not possible for us to take any view but one as to the meaning of that language. Thus, LORD HANWORTH, M. R. (97 L.J.K.B., at p. 217; [1928] 1 K.B., at p. 843; 13 Tax Cas. at p. 304), considering the meaning of the words in rule 19 "payable wholly out of profits or gains brought into

charge to tax" said that they "do not mean payment out of a fund that may be brought into charge, or is, or will be, a factor for the purpose of charge, but refer to a fund brought into charge out of which tax is payable and to be paid". And SARGANT, L.J. (97 L.J.K.B., at p. 218; [1928] 1 K.B., at p. 847; 13 Tax Cas. at p. 307) says this: "In my opinion the words 'brought into charge' are more naturally and satisfactorily satisfied by the meaning placed on them by the Crown. The past participle 'brought' naturally refers to something that has been completed in the year in question, if not by actual payment at any rate by accrued liability to pay. It is only in a looser sense that it can be applied to a payment or liability to pay in respect of a succeeding year". LAWRENCE, L.J., deals more particularly perhaps with the matter we have here to consider, and he, following LORD HANWORTH, said (97 L.J.K.B., at p. 221; [1928] 1 K.B., at p. 852; 13 Tax Cas., at p. 311): "I have arrived at the conclusion that the expression 'profits or gains brought into charge to tax' in rule 19 means the taxable, and not the actual, profits or gains in the year of assessment".

If that view, so expressed, is applied to the present case and, as I have said, I think it must be applied, we must have regard to its effect on Section 33 of the Finance Act, 1926, which has brought the present problem before the Court. The fact is that though the profits of the company during the year 1932 amounted to £69,908, the assessable profits in 1933-34 there had been as regards the years 1927-28 and 1928-29 loss to the extent of £82,085; so that the balance loss attributable to 1928-29 was £12,177. Now, under Section 33 (1) of the Finance Act, 1926, it is provided that: "Where a person has in any trade . . . sustained a loss . . . he may claim that any portion of the loss for which relief has not been so given shall be carried forward and, as far as may be, deducted from or set off against the amount of profits or gains on which he is assessed under Schedule D in respect of that trade. . . ." Therefore it follows from Section 33 that when the losses are taken into consideration as provided in Section 33, the difference is a balance loss of £12,177, and, applying the test which, as I say, has to be applied in the present case, I think it is impossible to say that there was during the year of assessment any sum at all of profits to be brought into charge to tax. In fact the result is that the profits computed on the basis of Section 33 amount to nothing, and when regard is had to the language of this Court to the effect that the profits brought into charge to tax refer

to the fund brought into charge to tax out of which tax is payable and to be paid, the result is that there is no such tax. Therefore, applying rule 19 in this way there is here no yearly interest of money payable wholly out of money brought into charge to tax, because, in my view, they were no profits.

That, in my opinion, is sufficient to determine this case in favour of the Crown. Counsel for the appellants argues, as I understand, that whatever has been said in the *Metropolitan Water Board Case*, which was dealing with a liability for the year of assessment, cannot apply to Section 33, but has a more limited meaning, because, says he, Section 33 of the Finance Act, 1926, assumes an assessment which, in this case, would show an assessment on the profit of £69,908, and that it is only after that assessment has been ascertained and—he says and, indeed, must say—brought into charge to tax, that the later limb of that section requires that the person assessed may claim that the portion of the loss may be deducted therefrom. In my view, it is impossible to apply that requirement to the judgment in the *Metropolitan Water Board Case*, because I think, as I have already said, that they are of general application. It is true that we have been referred to a case in the House of Lords, the *Central London Railway v. Inland Revenue Commissioners*, in which Lord Macmillan in his speech pointed out the very many difficulties and distinctions which might have to be met in dealing with this rule. But, in my view, it is not necessary here for me to consider how far that case may or may not have thrown light upon the decision of that Court. It is sufficient for me to say that I can find nothing in the speech of Lord Macmillan which in any way exonerates me from feeling bound by what has been said directly in interpreting rule 19 in this Court, and therefore I think that, important as that case may be, it would not be right to allow it to deflect one's judgment as derived from the positive decision referred to. For those reasons I think that this appeal fails.

ROMER, L.J.—I agree. This case is governed by the decision of the Court of Appeal in *Attorney General v. Metropolitan Water Board*, a case which, in spite of the criticisms to which it has been subjected in the House of Lords in the case to which SLESSER, L.J. has just referred *Central London Railway Co. v. Commissioners of Inland Revenue*—has never been overruled and is binding upon this Court. As I understand the *Metropolitan Water Board Case* the ground of the decision is, that no one is entitled to retain income tax which he has deducted from interest paid by him unless

he is in a position to say to the Crown: "I have already paid or become liable to pay this income-tax to you, because I have paid or become liable to pay income-tax on a sum which includes the interest which having regard to the rules for ascertaining profits under the Income Tax Act I was not allowed to deduct from any profits." I say that that appears to me to have been the ground of the decision in the *Metropolitan Water Board Case* for this reason, that LORD HANWORTH, M.R., after citing *London County Council v. Attorney-General*, said this (97 L.J.K.B., at p. 218; [1928] 1 K.B., at p. 845; 13 Tax Cas. at p. 305): "Both Lords MACNAGHTEN and DAVEY intended that the right to retain"—that is, to retain tax deducted from interest—"was co-extensive only with the liability to tax of the fund out of which the interest is paid." LAWRENCE, L.J., said (97 L.J.K.B., at p. 221; [1928] 1 K.B., at pp. 852, 853; 13 Tax Cas., at p. 311): "It follows that under the provisions of rules 19 and 21 no taxpayer can retain against the Crown any more income-tax deducted by him in any year of assessment than he has himself paid or become liable to pay to the Crown for that year." It is true that LORD MACMILLAN in *Central London Railway v. Inland Revenue Commissioners* in commenting upon that authority said (105 L.J.K.B., at p. 517; [1937] A.C., at p. 84; 20 Tax Cas., at p. 147): "The general principle of the *Metropolitan Water Board Case* may be stated thus: Whenever, in any year, the amount of interest paid by the taxpayer does not exceed the amount of his profits or gains as assessed for income-tax purposes for that year, then the interest paid in that year is, within the statutory meaning, 'payable out of profits or gains brought into charge to tax'." It will be seen LORD MACMILLAN there stated the principle of the *Metropolitan Water Board Case* in rather different language from that in which I have ventured to state it myself. It must, however, be remembered that LORD MACMILLAN was contemplating a case in which income-tax would in fact be paid on the profits assessed for income-tax and was not thinking of a case like the present where the profits of the year having been assessed, no income-tax becomes payable in respect of those profits, because the taxpayer is entitled to deduct something from that assessment. For those reasons I think this appeal fails.

GREENE, L.J.—I agree. Money received by a recipient of interest is treated by the Income Tax Acts as being what it in fact is—namely, his income. That is shown by the fact that, in the return of his total income which has to be made for certain

purposes, the gross amount of the interest payable to him must be included as part of his income. That income the Act sets out to tax, as it sets out to tax all other incomes. The way in which it sets out to tax it is by allowing or compelling the payer to deduct the appropriate amount when he makes payment. That amount in the hands of the payer, being as it is an amount equal to the tax on that part of the recipient's income, is a sum for which the payer is *prima facie* accountable to the Crown, but he can discharge himself of the liability so to account provided he can show that the payment of interest which he has made is referable to a fund, real or notional, in respect of which he has been charged or is liable to be charged to income-tax. The burden is upon him. In the present case, in my opinion, no such fund can be pointed to. Indeed, counsel for the appellants frankly admitted that the effect of this contention was that in the present case this piece of income which is unquestionably income of the recipient will escape payment of income-tax altogether. If that is the clear result of the legislation, effect must, of course, be given to it; but having regard to the circumstance, which I think is clearly established, that these provisions for deduction are in their essence machinery enabling the Crown to obtain payment of the tax payable in respect of the recipient's income, I think that a construction which leads to that result is to be avoided, if the language fairly permits of it. Counsel for the appellants in the present case attach very great importance to the circumstances that under Section 33 of the Finance Act, 1926, which is the section which gives rise to the present question, the particular machinery adopted for giving effect to the set-off of previous losses is not one whereby the assessment is reduced; the assessment is made and the assessment stands, but effect is given to the right to set-off by what the section calls a deduction from or set-off against profits. Here again counsel frankly admits that if the machinery adopted in the section had been one whereby the assessment was reduced, his argument could not have been sustained. In my opinion the distinction is much too fine a one. The substance of the matter is that whether the assessment is reduced or whether the assessment is left standing and the taxpayer is excused tax, the Crown has not been paid tax in respect of any ascertainable fund. That is the result of it, and in consequence it is impossible for the payer of the interest, in a case where Section 33 applies and to the extent to which it applies, to point to any fund, real or notional, out of which a real or notional payment of tax has ever taken place. The true fact is, that as the

result of the provisions of the section in the present case, no tax falls to be paid at all, and the result of that, as I have already said, is that, if the contention of counsel for the appellants is correct, this piece of income which is income of the recipient will never pay tax to the Crown at all.

The unreal nature of the distinction which he attempts to draw, based on the language of Section 33, becomes, I think, rather more apparent when one considers that there are in the Income Tax Acts two other provisions dealing with the question of losses and the machinery by which the taxpayer is entitled to relief in respect of them. I do not propose to refer at length to those provisions. One of them is Section 34 of the Income Tax Act, 1918, and the other is contained in rule 13 of the Rules to Cases I and II of Schedule D. When these provisions are examined it will be found that the language by which effect is to be given to the relief which the Legislature is minded to give to the taxpayer differs from that of Section 33, which we are now considering, and the machinery is different. The substance, nevertheless, is the same, and I for one am quite unable to draw that fine distinction based on the nature of the machinery provided when it is going to lead to a result which, in my opinion, is contrary to the whole sense and object of the legislation. I agree that the *Metropolitan Water Board Case* is really conclusive of the question here, and conclusive for the reason that it is impossible to point to a fund, real or notional, in respect of which tax has been or will be paid. I agree that the appeal should be dismissed with costs.

Appeal dismissed.

Solicitors;—*Elvy Robb & Co.*, for the Appellants : *Solicitor of Inland Revenue*, for the Crown.

(IN THE ALLAHABAD HIGH COURT).

KANWALNEN HAMIR SINGH

v.

COMMISSIONER OF INCOME-TAX, AJMER-MERWARA.

HARRIES and MULLA, JJ.

September 13, 1938.

FOREIGN INCOME—ASSESSEE HAVING HEAD OFFICE IN BRITISH INDIA AND BRANCHES IN NATIVE STATES—ACCOUNTS KEPT

ON MERCANTILE SYSTEM—INCOME CREDITED TO HEAD OFFICE IN BOOKS OF BRANCH OFFICES—WHETHER ASSESSABLE IN BRITISH INDIA—‘RECEIVED’, MEANING OF—MERCANTILE SYSTEM, INCIDENTS OF—CHANGE OF METHOD OF ACCOUNTING—PERMISSIBILITY—INDIAN INCOME-TAX ACT (XI OF 1922), Sections 4 (1), 13.

The assesseees who carried on money-lending and other forms of business had their headquarters in Ajmere in British India and branch offices in the Native States of Tonk and Jaipur. They kept their accounts in the mercantile system and had for many years past shown the sums credited to the Ajmere office in the books of the Tonk and Jaipur offices as part of the profits of the firm for income-tax purposes. Similarly, losses incurred outside British India were also treated as losses of the firm. The amounts credited to the Ajmere office in the accounts of the Tonk and Jaipur offices were not however shown as receipts in the Ajmere accounts. In the assessment for the year 1932-33, the assesseees contended that income which had accrued in Tonk and Jaipur could not under such circumstances be treated as having been brought to British India even though credited to the Ajmere office in the books of the branches and should therefore be excluded in calculating the income assessable in British India :

Held, that, as the assesseees had adopted the mercantile system of accounting and had in the past treated such income as having been received in India for income-tax purposes, such income should be treated as having been received in British India. By reason of Section 13 of the Act they cannot suddenly seek to change their method of accounting in order to avoid liability for payment of tax. Held, also, that the fact that no corresponding entries had been made in the books of the Ajmere firm was immaterial so long as the system of accounting followed was the mercantile system.

The interpretations put by the English authorities on the expression ‘received in the United Kingdom’ are not of much assistance in construing the Indian Act as the provisions of the English statute and Section 4 (1) of the Indian Act differ.

Commissioner of Income-tax v. Chunilal B. Mehta [1938 I.T.R. 521] and Gresham Life Assurance Society v. Bishop, [1902 A.C. 287] distinguished.

Commissioner of Income-tax, Madras v. A. T. K. P. L. S. P. Subrahmanyam Chettiar [50 Mad. 765] followed.

Cases referred to :

COMMISSIONER OF INCOME-TAX, BOMBAY v. CHUNNILAL B. MEHTA [1938] (1938 I.T.R. 521 ; 42 C.W.N. 1070).

COMMISSIONER OF INCOME-TAX, MADRAS v. A. T. K. P. L. S. P. SUBRAHMANYAM CHETTIAR [1927] (50 Mad. 765).

GRESHAM LIFE ASSURANCE SOCIETY v. BISHOP [1902] (1902 A. C. 287).

SHIVA PRASAD GUPTA v. COMMISSIONER OF INCOME-TAX, U.P. [1929] (A.I.R. 1929 All. 819).

Reference made by the Commissioner of Income-tax, Ajmere-Merwara, under Section 66 (3) of the Indian Income-tax Act, 1922. [Mis. Case No. 563 of 1935].

Sir Tej Bahadur Sapru, Sangar Saran and J. S. Gupta for the Assessees.

N. P. Asthana for the Commissioner of Income-tax.

JUDGMENT.

HARRIES, J.—This is a reference under Section 66 (3) of the Indian Income-tax Act, 1922, made by the Commissioner of Income-tax, Ajmere-Merwara.

The assessee in this case are a joint Hindu family carrying on business in the name of Kanwalnen Hamir Singh. The Headquarters of this business is situate at Ajmere, but the firm has branches in other places, both in British India and in Native States, where money-lending and other forms of business are carried on. The accounts of this firm have been for a long period maintained from Dewali to Dewali and the assessment in question is for the financial year 1932-1933.

A return of the income of this business for the year ending 10-11-1931 was submitted on September 28, 1932, for the purpose of the assessment to income-tax for the year 1932-1933. In this return the assessable income was shown as Rs. 1,54,601-6-7 and along with the return was submitted a Profit and Loss Account which is printed as Appendix F at p. 26 of the paper-book.

This return was not accepted as correct by the Income-tax Officer and the assessee were accordingly required to produce account books or any other evidence on which they relied to substantiate their return. During the course of examination of the account books an affidavit was filed by Dip Chand, the Munim of the assessee, in which he stated:—

(1) That no profits or interest accruing or arising in Tonk, Jaipur or Kotah branches were received in or brought into British India.

(2) That the amount of interest shown as debited to the capital account in the account books of Tonk, Jaipur and Kotah branches was not received in or brought into British India but were mere book entries to find out how the business in those branches was flourishing.

It must be pointed out that these contentions were raised for the first time in this affidavit and had never in previous years been put forward by the assessee. After examining the accounts and such evidence as was produced the Income Tax Officer assessed the income of the family at Rs. 2,71,576. This assessment was subsequently modified by the Assistant Commissioner in certain respects but such does not concern us in the present case.

The assessee then called upon the Commissioner either to revise the assessment with respect to various items or to state a case for the opinion of the High Court. With regard to several items with which we are not concerned the Commissioner allowed the applicants' contention and revised the assessment accordingly. With regard to other items the Commissioner disallowed the applicants' objections and refused to state a case on the ground that in his opinion no question of law arose.

By an order of September 8, 1936, this Court, however, directed the learned Commissioner of Income-tax to state a case with regard to the question arising in connection with interest on capital account credited to the Ajmere head firm in the books of the branches of the Indian States of Tonk and Jaipur respectively.

The question of law which arose in the opinion of this Court was stated by the learned Judges in these terms:—

“Whether in the circumstances of this case the two sums of Rs. 92,723-14-6 and Rs. 1,714-2-6 credited in the capital account in the name of the Ajmere firm in the books of the Tonk and Jaipur firms respectively can be said to have accrued or to have been received in or brought into British India by the Ajmere firm so as to render the Ajmere firm liable to pay the income-tax upon these sums of money?”

The learned Commissioner of Income-tax has now stated a case and has expressed his opinion that the question set out above should be answered in the affirmative.

The facts as stated by the learned Commissioner have not been disputed and indeed admit of no dispute. It transpires that out of the net income of the Tonk branch a sum of Rs. 32,723-14-6 was transferred to the khata of Ajmere in the capital account. The learned Commissioner observes that the assessee had two khata of Ajmere in the Tonk firm, one current account and the other a capital account khata. The amount paid as interest in the current account has not been taken into account in assessing the income of the assessee, but the amount of Rs. 32,723-14-6 credited in the capital account of the Ajmere firm has been regarded as a profit of the assessee and assessed accordingly. In the same manner a sum of Rs. 1,714-2-6 credited in the capital account of the Ajmere firm in the books of the Jaipur firm has been regarded as profit for the year in question and assessed accordingly.

There is no doubt whatsoever that these amounts have been credited to the Ajmere firm in the books of the branches at Tonk and Jaipur. It is however, to be noted that there are no corresponding entries in the books at the headquarters of the firm in Ajmere.

The learned Commissioner of Income-tax was of opinion that the book entries were tantamount to constructive receipt of these sums in British India and accordingly formed part of the profits of the firm which should be assessed for the year in question.

It has been contended by Sir Tej Bahadur Sapru on behalf of the assessee that the profits in question did not arise or accrue in British India and as they have not been received or brought into British India, they do not form part of the assessable profits of the assessee. He has contended that the mere fact that these sums are credited to the account of the headquarters at Ajmere which is in British India does not amount to a bringing in or a receipt of these profits in British India. On the other hand it has been contended on behalf of the Income-tax authorities that the crediting of these accounts to the Ajmere firm in the circumstances of this case is tantamount to a receipt of these profits in British India.

It has been found by the learned Commissioner that the accounts in all the various branches of this firm were maintained by the assessee on the mercantile system and that the assessee had always in past years submitted their returns in accordance with the profit and loss account prepared in precisely the same manner as the profit and loss account for the year in question which is printed at p. 26 of the paper book. The learned Commissioner points out that in past years the assessee had always included in

their income the interest credited to their capital account in the books of the branches situate in Indian States and did in fact include such income in their return for the year now in question. As we have pointed out earlier it was only when the Income-tax Officer had called for the books of account that this question was raised for the first time.

Section 4 of the Indian Income-tax Act deals with the scope of that Act. Section 4 (1) of the Act is in these terms :

“ Save as hereinafter provided this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing or arising, or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British India.”

Section 4 (2) provides that income, profits and gains accruing or arising outside British India to a person resident in British India which are received or brought into British India shall be deemed to have accrued or arisen in British India and to be income, profits and gains for the year in which they were so received subject to the provisions of the proviso immediately following. Then follows an explanation which is in these terms :—

“ Income, profits or gains accruing or arising without British India shall not be deemed to be received or brought into British India within the meaning of this sub section by reason only of the fact that they are taken into account in the balance sheet prepared in British India.”

Section 6 sets out the heads of income, profits and gains which are chargeable to income-tax and these include the head “ Business ” and Section 10 (1) of the Act provides that the tax shall be payable by an assessee under the head “ Business ” in respect of profits or gains of any business carried on by him.

According to the assessee's contention the sums in question which have been credited to the account of the Ajmere firm in the books of the Tonk and Jaipur firms were profits which arose or accrued outside British India. Further, it is argued that nothing which has occurred in this case can amount to bringing in of these profits into British India or a receipt of the profits by the assessee in British India.

It has been argued that the profits made by the Tonk and Jaipur branches respectively were not profits arising or accruing in British India and reliance is placed upon the case of *The Commissioner of Income-tax, Bombay v. Chunni Lal B. Mehta, Bombay*. In that case the assessee carried on the business of a broker

at Bombay and in the course of his business he entered into transactions in cotton in Liverpool, London, New York and elsewhere. Some of those transactions proved profitable but no attempt was made to bring such profits into British India. The Income-tax authorities at Bombay assessed the assessee on such profits but their Lordships of the Privy Council held that the profits made on transactions entered into in foreign places were not profits which accrued or arose in British India. This point has not been contested by counsel for the Income-tax authorities. He conceded that the profits made at Tonk and Jaipur were not profits which accrued or arose to the assessee in British India. He, however, argued that they had been brought into or received in British India and were therefore assessable.

On behalf of the assessee it is urged that there has been no bringing in or receipt of these profits in British India. It is argued that the mere crediting of the sums in question to the capital account of the Ajmere firm in the books of the Tonk and Jaipur branches cannot amount to bringing in the profits to British India or to a receipt of such profits in British India. According to the assessee in order that profits made outside British India should be taxable in British India such profits must actually have been physically received in British India and a mere book entry cannot amount to such receipt. It is further pointed out that in this case no entries corresponding to the entries in the books of the Tonk and Jaipur branches appear in the books of the Ajmere firm. The meaning of the phrase "received in the United Kingdom" in relation to interest arising from foreign securities was considered in the case of *Gresham Life Assurance Society Ltd. v. Bishop*. In that case a life Assurance Society carried on business in England and abroad. The head office was in London where the accounts and balance sheets were made out, the profits ascertained and the dividends paid. The interest upon the society's foreign securities paid abroad was received there by their agents and part of it was applied abroad for the purposes of the society. All the interest on foreign securities was however taken into account in the balance sheets upon which the profits were ascertained. The House of Lords held that interest arising upon foreign securities and paid abroad was not "received in the United Kingdom" within the meaning of the Income-tax Act, 1842, Section 100, Schedule D, and was therefore not chargeable with income-tax under that Clause, unless it was remitted to the United Kingdom. Further that taking such interest into account was not equivalent to a

receipt in the United Kingdom and that income-tax was not chargeable upon such part of the interest which was not remitted to the United Kingdom. It is to be observed that the English Income-tax Act, 1842, contained a very similar phrase to that contained in Section 4 of the Indian Income-tax Act, viz., "received in the United Kingdom" and there can be no doubt that the House of Lords held that the mere showing of such interest or profits in the balance sheets prepared in the United Kingdom did not amount to receipt. At page 292 [of 1902 R.C.] LORD MACNAGHTEN observed:—

"I do not understand what is meant by constructive receipt in such a case as this, or how any sums can be said to have been received in the United Kingdom unless they have been brought to the United Kingdom, or unless there has been a remittance 'payable in the United Kingdom,.....The circumstances that the business of the society is 'one indivisible business', and that the society in the statement of its affairs and in its dealings with its shareholders and customers takes into consideration its foreign assets and liabilities, seems to me to be immaterial to the present question. As my noble and learned friend LORD ROBERTSON, when Lord President, observed in *Forbes v. Scottish Provident Institution*, 'Every man and every company having foreign or colonial investments, of course, knows of the interest arising from them, takes note of it and enters it in any statement of affairs which may require to be made up'. But that, as I think, and as the Lord President thought, is a very different thing from bringing the interest home—a very different thing from the receipt of the money here, either in specie or as represented by a remittance payable in this country".

It has been contended that the cases of *Gresham Life Assurance Society Ltd. v. Bishop and Commissioner of Income-tax v. Chunni Lal B. Mehta* already referred to establish beyond all doubt that the profits in the present case cannot be said to have been received by the Ajmere firm in British India. We must observe at this stage that the case of *The Commissioner of Income-tax v. Chunni Lal B. Mehta* does not really touch the question in issue in this case because it was admitted in that case that the income-tax authorities were bound to fail unless it could be shown that the profits in question accrued or arose in British India. In the opening portion of the judgment of the Board, Sir George Rankin observed:—

"The assessee disputes his liability in respect of such profits on the ground that they were not profits 'accruing or arising in British India'. It is conceded that they are not otherwise chargeable

they have not been received in British India nor do they come under any of the provisions whereby they can be deemed to accrue or arise or be received in British India ”.

It is therefore clear that in the case of *The Commissioner of Income-tax v. Chunni Lal B. Mehta* their Lordships of the Privy Council were not called upon to consider whether the profits made in transactions in Liverpool, London and New York could be deemed to have arisen or accrued or be received in British India. The case of *Gresham Life Assurance Society Ltd. v. Bishop* is, however, in point because it deals with the meaning of the phrase “received in the United Kingdom ”.

In our view, however, the English authorities can be of little assistance in this case because the statute which was under consideration in *Gresham Life Assurance Society Ltd. v. Bishop* did not contain everything which is contained in Section 4 (1) of the Indian Income-tax Act. As we have already pointed out that subsection provides that the Act is to apply not only to income, profits or gains accruing or arising or received in British India but also to all such income, profits and gains which are deemed under the provisions of the Act to accrue or arise or be received in British India. There was nothing corresponding to this latter provision in the Income-tax Act, 1842, which was under consideration in the House of Lords case to which we have referred.

It has been argued on behalf of the income-tax authorities that though it might be said that the profits of the Tonk and Jaipur branches arose and accrued out of British India they must now be deemed to have accrued or arisen or to have been received in British India. Counsel for the income-tax authorities has to concede that there has been no physical handing over of this sum, but he contends that under the provisions of the Income-tax Act the profits must now be deemed to have accrued or arisen or to have been received in British India.

As we have pointed out earlier in this judgment the accounts of the Tonk and Jaipur branches as indeed the accounts of all the branches of this firm, were kept on the mercantile system and further that the assessee had for many years past shown the sums credited to the Ajmere firm in the books of the branches in Native States as part of the profits of the firm for the year during which they were so credited. These are findings of fact which cannot be challenged and are indeed not challenged in this case. Section 13 of the Indian Income-tax Act provides that

"Income, profits and gains shall be computed for the purposes of Sections 10, 11 and 12 in accordance with the method of accounting regularly employed by the assessee".

It is argued on behalf of the income-tax authorities that the income or profits of this firm must be computed in accordance with the method of accounting regularly employed by the firm and admittedly such method of accounting has been on the mercantile system. By that method of accounting the sums credited to the account of the Ajmere firm in the books of the Tonk and Jaipur branches have always been treated as profits of the Ajmere firm and it is now contended that it is too late for the assesseees to attempt to change their method of accounting so as to render these profits not taxable in British India.

The mercantile system of accounting was discussed by a Bench of this Court in *Shiva Prasad Gupta v. Commissioner of Income-tax, U. P.* At p. 823 (of A.I.R. 1929 All.) Mukerji, J. described the mercantile accountancy system in these terms:—

"That system is this. In any particular year the amounts that have become recoverable as shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed. Under this system, the merchant, in order to ascertain his income which is really a 'book income' deducts from the profits accrued according to his books, the losses that he has suffered, also according to his books. The balance is a net book income. Under Section 13 of the Income-tax Act this net 'book income' may be accepted by the Income-tax Officer as a fair estimate of the merchant's income. The reason will be two-fold. The merchant himself uses this method of ascertaining his own income and secondly the method is not an unfair one".

According to the case stated the assesseees in order to ascertain their income have for many years deducted from the profits earned according to their books the losses which they have suffered also according to their books and have treated the balance as a net "book income" and they have been assessed year after year upon this basis. Counsel for the income-tax authorities therefore contends that as this has been the assesseees' own system they cannot now seek to change it. A perusal of the profit and loss account printed at p. 26 of the paper book shows that the assesseees have treated as profits sums credited to the account of the Ajmere firm in the books of the branches situate outside British India and further have shown as losses, losses incurred by those firms outside British India. The assesseees have by their system of accounting

treated the profits made outside British India as profits received in British India and have also treated losses incurred outside British India as losses of the firm in British India. It has been contended on behalf of the income-tax authorities that no distinction can be drawn between the present case and the case of *The Commissioner of Income-tax, Madras v. A. T. K. P. L. S. P. Subramaniam Chettiyar*. In that case an assessee who had a business of his own in Rangoon and a partnership business at Penang advanced a sum of money from the Rangoon firm to the Penang business; it appeared that interest on that advance was credited in the account of the Rangoon business, though no amount was actually received from Penang; the assessee had chosen to adopt the mercantile basis in his accounts. On his being assessed to income-tax in respect of such interest, the assessee contended that he was not liable as it was not income which accrued, arose or was received in British India. A Full Bench of the Madras High Court, however, held that the interest in question was not profit or gain arising without British India but was income which properly accrued or arose in British India within Section 4 (1) of the Indian Income-tax Act (Act XI of 1922). The assessee having chosen to adopt the mercantile basis of accountancy in keeping his accounts, it was upon that basis, and upon that basis alone, that he was to be assessed to income-tax under Sections 10 and 13 of the Act. It appears to us that one distinction of fact and only one can be drawn between the present case and the Madras Full Bench case. In the present case the sums in question were credited in the books of the Tonk and Jaipur branches respectively to the account of the Ajmere firm but apparently unlike the Madras case no corresponding entries appear in the books of the Ajmere firm. The fact that no corresponding entries were made in the books of the Ajmere firm cannot, in our view, however, affect the question if we are satisfied that the system of accountancy followed in this case was that known as the mercantile system. The assessee cannot avoid the consequences by merely omitting to make an entry in the books of the Ajmere firm. The entries were made in the books of the Tonk and Jaipur firms and further the sums credited to the Ajmere firm were shown year after year as part of the profits of the Ajmere firm and similarly the losses of the branches situate outside India were also shown as the losses of the Ajmere firm. In our view there is no real distinction between the present case and the Madras Full Bench case to which we have referred and further in our view the Full Bench of the Madras High Court

correctly laid down the law. In our judgment though the profits making up the two sums in question in this case did not actually arise or accrue in British India and were not physically transferred to or received in British India, such profits however, must be deemed by reason of Section 13 of the Act to have arisen or accrued in British India or to have been received in British India. The assesseees have always in the past treated such profits as having been received in British India and their accounts on that basis have always been accepted by the taxing authorities. By reason of Section 13 of the Act they cannot now seek suddenly to change their method of accounting in order to avoid liability for payment of tax upon these sums. In our judgment the view expressed by the learned Commissioner of Income-tax is right and accordingly we answer the question submitted in the affirmative.

The assesseees must pay the costs of these proceedings which we assess at Rs. 200.

Reference answered accordingly.

[IN THE PATNA HIGH COURT].

THE COMMISSIONER OF INCOME TAX, BIHAR
AND ORISSA

v.

MAHARAJADHIRAJA SIR KAMESHWAR SINGH
OF DARBHANGA.

WORT, A. C. J. and MANOHAR LAL, J.

July 20, 1938.

LOSS—MONEY-LENDING BUSINESS—INVESTMENT IN SHARES—
WINDING UP OF COMPANY—NEW COMPANY TAKING UP ASSETS OF
OLD COMPANY—AGREEMENT BY NEW COMPANY TO ISSUE DEBENTURES TO SHAREHOLDER IN OLD COMPANY—DEBENTURES NOT ISSUED—LOSS, WHETHER CAPITAL LOSS OR TRADING LOSS—
INDIAN INCOME TAX ACT (XI OF 1922), Section 24 (1).

The assessee purchased shares to the value of Rs. 8,75,000 in a company. This company went into liquidation but a new company which was formed to acquire the assets of the old company agreed to allot a specified number of shares and debentures to every member of the old company. In this way the assessee obtained in the new com-

pany shares to the value of Rs. 4,800 and a promise of debentures to the extent of Rs. 5,72,000. No debentures were however issued by the new company and in the liquidation of this company which followed, the assessee received only Rs. 77,400. The assessee claimed that the loss of Rs. 4,98,900 which he had thus suffered should be allowed as a deduction from, or be otherwise set off against, his income. On a reference by the Commissioner:

Held, that, as there was no evidence to show that the assessee was a person whose business was to trade in shares, the loss incurred by the assessee was clearly a loss of capital and could not be deducted from, or set off against, his income, profits and gains.

Case stated by the Commissioner of Income-tax, Bihar & Orissa, under Section 66 (2) of the Indian Income-tax Act: [Miscellaneous Judicial Case No. 25 of 1937].

STATEMENT OF CASE.

"The following case is stated for the decision of the Hon'ble Judges of the High Court under Section 66 (2) of the Indian Income-tax Act, XI of 1922, (hereinafter referred to as the Act).

2. Maharajadhiraja Sir Kameshwar Singh of Darbhanga (hereinafter referred to as the assessee) was assessed by the Income-tax Officer, Darbhanga, for the assessment year 1933-34 (previous year 1339 *Fasli*) on a total income of Rs. 11,11,267. This total income having been ascertained, income-tax and super-tax were levied upon the assessee and a demand notice issued accordingly. Thereupon the assessee filed an appeal under Section 30 of the Act before the Assistant Commissioner, Northern Range, Muzaffarpur, wherein he objected to various items in the computation of his taxable income by the Income-tax Officer. After this appeal was disposed of, the assessee presented a petition under Section 66 (2) of the Act to my predecessor, asking for a case to be stated in respect of certain questions, said to be questions of law, arising out of the Assistant Commissioner's appellate order. Of the five questions formulated, two were decided in the assessee's favour by my predecessor, one was rejected as involving no question of law and one was dropped by the assessee. The fifth is the question which is now being referred for the decision of the Hon'ble Judges of the High Court.

3. This question concerns the disallowance of a sum of Rs. 4,98,900 which was laid out for the purchase of debentures of the Eastern Coal Syndicate (1924), Ltd., but which was subse-

quently lost. The question which has been formulated by the assessee is as follows :—

“ Whether the money advanced for the debentures and misused for the liquidation proceedings, instead of being returned at once under the Indian Companies Act, Section 109, changed the character of the advance into a loan ? ”

In my opinion, it would be more suitable to state the question in issue thus :

“ Whether the loss of Rs. 4,98,900 suffered by the assessee in connection with the purchase of debentures in the Eastern Coal Syndicate (1924) Ltd., can be allowed as a deduction from, or be otherwise set off against, his income, profits or gains for purposes of his assessment for the assessment year 1933 34 ? ” This is accordingly the question which I refer for decision.

4. A summary of the facts relating to this transaction is given in the annexed extract from the Income-tax Officer's assessment order. The facts are also set out in greater detail in the extract from the Assistant Commissioner's order. Briefly, the facts are that in 1920 the assessee purchased shares of the face value of Rs. 8,75,000 in the Eastern Iron Coal Company Ltd. That Company (which for convenience will be referred to as the old Company) went into liquidation in 1924 and by an agreement executed on the 25th June 1924 with the Eastern Coal Syndicate (1924) Ltd., (hereinafter designated as the new company), it was wound up by voluntary liquidation and the new company was formed to take over all its old assets and undertakings including its good-will and, as a part of the consideration for this transfer, the new company agreed to allot to the liquidator of the old company a certain number of shares and debentures. The new company also agreed to allot a specified number of shares and debentures to every member of the old company. In this way, the assessee, as a shareholder in the old company, obtained in the new company 43 shares of Rs. 100 each and a promise of debentures of Rs. 5,72,000 in exchange for the shares held by him in the old company. The promise of debentures in the new company was, however, never fulfilled, as no debentures were issued by it. Finally, the new company also went into liquidation. The liquidation proceedings terminated on the 19th December 1931 and against his shares of the face value of Rs. 4,300 and the promised debentures of the value of Rs. 5,72,000 the assessee received Rs. 51,600 in cash and Rs. 25,800 in Government Promissory notes. The net result was thus a loss of Rs. 4,98,000. The assessee claims that this loss was

sustained in *Fasli* year 1339, which is the accounting year in respect of the 1933-34 assessment, and in support of this claim he refers to a certificate dated the 29th March 1932, which is in the following terms :—

“Certified that the liquidation proceedings of Eastern Coal Syndicate (1924) Ltd., have been finished on 19th December 1931 and that the total amount paid to Maharajadhiraja Kameshwar Singh Bahadur of Darbhanga on account of the shares of the face value of Rs. 4,300 and debentures of the value of Rs. 5,72,000, was Rs. 51,600 in cash and Rs. 25,800 in 4 per cent. Government Promissory Notes of 1960-70. The last payment was made to him on 20th May 1931 and there are no more assets available”.

It may be taken that the loss occurred in the accounting year and that, if it were admissible, it would have to be allowed in the 1933-34 assessment now under consideration.

5. The only provision in the Act under which a loss can be set off against taxable profits is Section 24 (1). This section in terms refers to loss of “profits or gains” and it clearly does not permit the set off of a loss of capital. Now it is admitted by the assessee that the venture on which he embarked was in its origin in the nature of an investment in company shares having no connection whatsoever with his ordinary money-lending business. On this admission of fact no other conclusion is possible than that the loss incurred on the venture was a capital loss. It therefore cannot be set off against his taxable profits under Section 24 (1). In this connection I invite attention to the decision of the Bombay High Court in the case of *Sir Chinubhai Madhowlal, Bart v. Commissioner of Income-tax, Bombay* (1937 I.T.R. 210; IX I.T.C. 345) wherein it was held that a loss incurred in somewhat similar circumstances could not be treated as a loss of profits or gains under any of the heads of income in Section 6 of the Act and set off against income under any other head for purposes of assessment. But the assessee's case is that, although the original venture was in the nature of a pure investment, the subsequent events altered its character into that of a loan advanced to the new company and as such the loan became part of his ordinary money-lending business and since it has become irrecoverable, it should be deducted in computing the profits of that business. This position is, in my opinion, wholly untenable. All that happened when the old company was wound up and was succeeded by the new company was that the assessee's investment was transferred from the one to the other. There was no act by the assessee or by the new

company which altered the character of the outlay. The transaction remained what it was, viz., an investment pure and simple unconnected with the assessee's money-lending business. The loss cannot, therefore, I submit, be treated as an irrecoverable loan and allowed as a deduction in computing the profits of the money-lending business. For these reasons the question referred should, in my humble opinion, be answered in the negative."

S. M. Gupta, for the petitioner.

Sir Sultan Ahmed, Murari Prasad and S. P. Srivastava, for the assessee.

JUDGMENT.

WORT, A. C. J.—The case which has been stated by the Commissioner of Income-tax arises out of the following circumstances. The assessee purchased shares to the value of Rs. 8,75,000 in the Eastern Iron Co., Ltd., which went into liquidation in the year 1924. Out of that liquidation a new Company was formed known as Eastern Coal Syndicate Ltd. This company having acquired the assets of the old company, agreed to allot certain shares and debentures to members of the old company. In that agreement the assessee was promised 43 shares of Rs. 100 each and debentures to the extent of Rs. 5,72,000. This agreement was not fulfilled inasmuch as all the debentures were not granted to the assessee as promised. It will be seen from the figures I have given that the assessee has lost a considerable sum of the money of his original investment made in Eastern Iron Co., Ltd. His contention before this Court and the question which is submitted to this Court for opinion is whether that loss is to be treated as a capital loss or loss of income and, if the latter, whether it can be taken into consideration in assessing the assessee's income for the purpose of income-tax.

Sir Sultan Ahmed appearing on behalf of the assessee contends that in considering the matter the investment in the original company must be excluded from one's attention; that it must be treated merely as an agreement by the new company to grant these debentures, and also that it must be treated as a loan by the assessee to the new company. That a debenture in essence is a loan and debenture in essence is a mortgage may be true, but it is impossible to accept the argument put forward by Sir Sultan Ahmed in this respect. Indeed it is a self-destructive one. First, it seems to disregard the original investment which cannot be done, because the right of the assessee under the investment is the basis

of the contract entered into by the new company and is the consideration for that contract. Secondly, if we are to disregard the existence of the original investment, then all that we have is a promise by the new company to grant debentures to the assessee which, as my learned brother pointed out in the course of the argument, is a *nudum pactum* in the circumstances. If a *nudum pactum*, the assessee has lost nothing—neither income nor capital. But we are bound in deciding this question to take into consideration the fact of the original investment. Now, if the assessee had been a person whose business was to trade in shares, the loss which he has sustained might have been taken into consideration in computing his profits assessable to income-tax; but there is no such finding and it would be impossible in the circumstances to have arrived at any such finding. It is clear that the difference between what the assessee has in fact got and what he originally invested is a loss which is clearly a loss of capital and therefore it cannot be taken into consideration for the purpose of arriving at the assessable income.

The question submitted therefore must be answered in the negative. The Crown is entitled to costs assessed at five gold mohars.

MANOHAR LAL, J.—I agree.

Question answered in the negative.

[IN THE COURT OF APPEAL].

INLAND REVENUE COMMISSIONERS

v.

LAWRENCE, GRAHAM & CO.

LORD WRIGHT, M.R., ROMER, L.J.

Feb. 1, 2, 3. March 3, 1937.

INCOME TAX AND SURTAX—MORTGAGE ON SECURITY OF REVERSIONARY INTEREST—ARREARS OF INTEREST TO BE ADDED TO PRINCIPAL SUM—ADDITIONS MADE AFTER DEDUCTIONS OF TAX—SALE OF REVERSION BY MORTGAGEES—PAYMENT TO MORTGAGEES' SOLICITORS OF TOTAL SUM ADDED TO PRINCIPAL—PAYMENT BY THEM TO MORTGAGEES—CLAIM AGAINST THEM FOR INCOME TAX IN RESPECT OF AMOUNT SO PAID—INCOME TAX ACT, 1918 (8 & 9 Geo. 5. c. 40), ALL SCHEDULES RULES, r. 21 (2).

On the security of a reversionary interest, £ 25,500 were advanced by certain mortgagees, it being provided that till falling in of the reversion any interest which was calculated at such a rate that, after deduction of income-tax, there would remain a net sum of so much per cent. more than thirty days in arrears should be added to the principal and at diverse times sums representing the amount of such interest were added accordingly to the amount of £ 2,378. On a sale of the reversion by the mortgagees, in exercise of their power, it was agreed that £ 25,000 should remain on mortgage, a sum of £ 6,000 representing the balance of the purchase money being paid to their solicitors who out of it paid £ 2,378 to their clients and the remainder to a second mortgagee:—Held, (1) that the interest could not be treated as having been paid by the mortgagor half yearly out of sums advanced to him for that purpose by the mortgagees, but (2) that the effect of the provision was that the mortgagees agreed to accept in place of any interest payment which the mortgagor might fail to make, that is, the net amount of the interest after deduction of tax which was all the mortgagor could have been liable to pay, a capital charge on the mortgage security for a like amount, and (3) that accordingly when the solicitors paid to the mortgagees out of the purchase-money the sums that had been so added to the principal moneys secured, they were paying a sum that had already suffered tax and were under no liability to make any further deduction under rule 21 of the General Rules applicable to All Schedules of the Income Tax Act, 1918. They were not making a payment of interest within the meaning of the rule.

Decision of LAWRENCE, J., affirmed but on other grounds.

Marland v. Inland Revenue Commissioners [1934] (19 Tax Cas. 467) disapproved.

Cases referred to:

BEVAN, *Ex parte* [1803] (9 Ves. 223).

CARNABON (EARL) *v.* INLAND REVENUE COMMISSIONERS, [1934] (19 Tax Cas. 455).

CLANCARTY (LORD) *v.* LATOUCHE [1810] (1 Ball. & B. 420).

HOWARD *v.* HARRIS [1683] (1 Vern. 190).

INLAND REVENUE COMMISSIONERS *v.* HOLDER [1931] (100 L.J.K.B. 489; (1931) 2 K.B. 81; affirmed in H.L. (1932) 101 L.J.K.B. 806; (1932) A.C. 624: 16 Tax Cas. 540).

MARLAND v. INLAND REVENUE COMMISSIONERS [1944] (19 Tax Cas. 467).

RUFFORD v. BISHOP [1829] (7 L.J. (o.s.) Ch. 108; 5 Russ. 346).

Appeal from a decision of LAWRENCE, J.

The facts are fully stated in the considered judgment of the Court delivered by ROMER, L.J., as also rule 21 of the All Schedules Rules.

The Attorney-General (Sir Donald Somervell, K.C.), J. Stamp, and R. P. Hills, for the appellants.

Latter, K. C., and Cyril King, for the respondents.

JUDGMENT.

LORD WRIGHT, M. R.—ROMER, L.J., will deliver the Judgment of the Court.

ROMER, L J.—This appeal comes before us in the following circumstances: By a mortgage dated January 13, 1925, a reversionary interest was assigned to the Legal and General Assurance Society (hereinafter referred to as "the society") to secure a sum of £10,000. The deed contained a covenant by the mortgagor to repay the sum advanced and also a covenant to pay half-yearly such a rate of interest thereon that after deduction of income-tax from each periodical payment there would remain a net sum equivalent to interest for the same period on the principal money for the time being remaining due at the rate of $5\frac{1}{2}$ per cent. per annum, reducible on punctual payment to $4\frac{1}{2}$ per cent. The mortgage also provided in Clause 5 (B) that in case before the death of the survivor of the two life tenants (therein named) on whose deaths the reversions were expectant "any interest on the principal money hereby secured or on any accumulations of interest arising under this present provision and added to principal money should not be paid on any half-yearly day hereinbefore appointed for payment of interest or within thirty days after such half-yearly day then from and after such default in payment and until the death of the survivor of the two life tenants (but without prejudice to the right of the society to require payment or the right of the borrower after due notice to make payment of the principal moneys and interest and accumulations of interest hereby secured) the sum due in respect of the half-year's interest so unpaid shall be converted into and become principal money as from the half-yearly day on which it becomes due and be added to the principal money hereby secured and shall carry interest at the rate aforesaid from

the half-yearly day on which such half-year's interest became due and the interest upon all sums so converted into principal money shall be payable on the half-yearly days aforesaid but so that all interest unpaid on the original principal sum hereby secured and on all sums converted into principal money under this present provision shall become accumulated in the way of compound interest with half yearly rests and the accumulated fund as well as the original principal sum hereby secured and the interest on such fund and sum shall constitute a charge upon the premises hereby mortgaged and the premises hereby mortgaged shall not be redeemed except upon payment of all principal moneys hereby secured and all interest and accumulations made as aforesaid of interest on such principal money and accumulations."

By two deeds of further charge dated December 14, 1926, and July 4, 1928, respectively, further advances were made by the society to the mortgagor bringing the total sum advanced up to £25,500. Except that in the case of the latter of these two deeds the net rate of interest was £5 12s. 6d. per cent. per annum, reducible on punctual payment to £4 12s. 6d. per cent. the further advances were made on precisely the same terms as applied to the original advance.

Default was made by the mortgagor in paying the half-yearly interest due on April 15, 1939, and all the interest that fell due after that date down to January 10, 1932. Such interest was accordingly added to the principal money under the provisions of clause 5 (B) of the mortgage deed of January 13, 1925, which provision had been incorporated in the deeds of further charge. The amount so added to the principal was the net amount of the interest calculated at the lower rates mentioned in the deeds after deducting therefrom income-tax at the appropriate rate. The total amount so added to the principal sum of £25,000, calculated to January 10, 1932, was £2,378 19s.

In the meantime, by deed dated October 14, 1929, the mortgagor had created a second mortgage on the reversionary interest to secure a principal sum advanced by a second mortgagee and interest thereon as therein mentioned.

By deed dated March 14, 1932, the society, in exercise of their power of sale as mortgagees, assigned the reversionary interest to a purchaser for the sum of £30,500. Of this sum it was agreed that £25,500 should remain on mortgage, with the result that, upon completion of the sale, a sum of over £ 6,000 representing the balance of the purchase-money with certain interest thereon

became payable by the purchaser. It was not, however, paid to the society but to the respondents, Messrs. Lawrence, Graham & Co., as the society's solicitors. The respondents thereupon paid the society the sum of £ 2,378 19s. and a further sum representing net interest accruing to the society but not yet added to capital, and after paying the costs of the sale paid the balance of the money received from the purchaser to the second mortgagees. The sum representing net interest accruing under the society's mortgage and not added to capital was less than the interest paid by the purchaser on his purchase-money, and this latter interest had been paid by the purchaser after deducting income tax thereon. Moreover, as already stated the interest that had been added to the principal money due to the society was net interest only, that is is to say, the gross interest after deduction of tax.

In these circumstances it would not at first sight appear that the society, and still less the society's solicitors, could be assessed to income tax in respect of any of the money received by the society out of the proceeds of sale of their mortgage security. An assessment was nevertheless made upon the solicitors for the year 1931-1932, it being sought to justify such assessment under the provisions of rule 21 of the General Rules applicable to All Schedules of the Income Tax Act, 1918, amended by Section 26 of the Finance Act, 1927.

That rule, so far as is material, is in these terms : " (1) upon payment of any interest of money . . . charged with tax under Schedule D . . . not payable or not wholly payable out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of the payment.

" (2) Where any such payment as aforesaid is made by or through any person, that person shall forthwith deliver to the Commissioners of Inland Revenue, for the use of the Special Commissioner, an account of the payment, or of so much thereof as is not made out of profits or gains brought into charge, and of the tax deducted out of the payment or out of that part thereof, and the Special Commissioners shall assess and charge the payment of which an account is so delivered on that person.

" (2-A) The Special Commissioners may, where any person has made default in delivering an account required by this Rule, or where they are not satisfied with the account so delivered, make an assessment according to the best of their judgment. . . ."

It is not necessary for the purposes of this judgment to state the precise amount of the assessment or the way in which it was calculated; for the calculation was complicated by the fact that credit was given for certain profits and gains of the mortgagor that had been brought into charge and by the payment of interest on the purchase-money. But assuming, for the sake of simplicity that these complications did not exist, the contention on the part of the Crown can be stated as follows: when the sum of £ 2,378 19s. was paid to the society out of the purchase-money there was a payment of interest, within the meaning of rule 21, not payable out of profits or gains brought into charge; the respondents were persons by or through whom such payment was made, and are therefore liable to be assessed in an amount arrived at by "grossing" the said sum.

The respondents in due course appealed against the assessment and the appeal was allowed by the Special Commissioners. They held, purporting to follow a decision of this Court and two decisions of SINGLETON, J., to which we refer later, that the interest was, or must be deemed to have been, paid by the mortgagor at the respective dates when it was added to the capital out of fresh advances made to him by the society for that purpose and that, to this extent there was no payment of interest when the property was sold. They accordingly discharged the assessment. They were, however, of opinion, in case they were wrong in holding that the interest had been paid by the mortgagor—treating again the complications above referred to as non-existent—(1) that the society were paid the interest by the respondents out of the purchase-money; (2) that the society received it under deduction of tax; (3) that the respondents were the persons through whom the interest was paid to the society; and (4) that the respondents having deducted tax from the interest were liable to account for the tax so deducted.

The case was then taken by way of appeal to LAWRENCE, J., who affirmed the decision of the Commissioners that the interest had been paid by the mortgagor, holding himself bound by the three cases which the Commissioners had purported to follow. He expressed no opinion upon the liability of the respondents to assessment should it be held that the interest had not been paid by the mortgagor.

From that decision of LAWRENCE, J., an appeal has been taken to this Court and now falls to be decided.

For the purpose of our decision it becomes necessary, in the first place, to consider the cases on which the Commissioners and LAWRENCE, J., relied.

The first of these is *Inland Revenue Commissioners v. Holder*. That was a case in which a company had been allowed an overdraft by its bankers, on which overdraft the bank were entitled to charge interest. In accordance with the usual practice of bankers the balance of principal and interest was struck at the end of each half-year and the aggregate sum was introduced as the first item in the subsequent half-yearly account, and interest calculated upon it. In other words the company was charged compound interest. In these circumstances this Court held that the bank must be regarded as having made, each half-year, an advance to the customer of a capital sum equal in amount to the interest then falling due which sum had been applied by the customer in paying that interest. There had been no express agreement between the parties as to the charging of compound interest by the bank. The bank, in charging it, had merely followed the ordinary practice of bankers, and the customer had acquiesced in their doing so. But that practice of bankers is an old one dating back to long before the repeal of the usury laws, and could not, therefore, have been legal unless it was consistent with those laws. Now before the repeal of those laws a contract to allow the charging of compound interest was illegal. The legality of the practice of bankers was, however, upheld by the Courts by treating the bank as making a fresh advance to its customer at the end of each year or half-year as the case might be. See, for example, *Clancarty (Lord) v. Latouche*. There is nothing contrary to the usury laws in such an arrangement. See *Bevan, Ex parte*. It is plain that upon the repeal of those laws an agreement to pay compound interest became lawful. In *Holder's Case*, however, there was no agreement to pay it. The bank had merely pursued an old practice of bankers upon which an interpretation had been put by the Courts. The fact that this had been done at the time when the laws against usury were in force appeared to this Court to be immaterial. The practice continued after the repeal of those laws and the repeal could not affect the nature of the practice.

But a stipulation in a mortgage deed for payment of compound interest stands upon a different footing. Before the repeal of the usury laws such a stipulation would have been illegal, except perhaps in the case of a mortgage of a reversionary interest, in which case there is some ground for thinking that even in those

days it would have been supported. (See *Howard v. Harris*, 1 Vern., at p. 194). The question whether since the repeal of the usury laws effect would be given to such a stipulation in a mortgage, not being one of a reversionary interest, has caused some difference of judicial opinion. The matter is elaborately discussed on *Coots on Mortgages* (7th edition, Vol. 1, pp. 139-143), but need not be discussed here. For, even if such a stipulation would still be ineffectual as between mortgagor and mortgagee if the former should choose to dispute it, the difficulty would not be got over by treating the stipulation as one that provided for fresh capital advances being made by the mortgagee from time to time. The stipulation would not, by being so construed, become any the less objectionable. The cases relating to the practice of bankers in charging compound interest have not, therefore, any application to mortgage transactions. (See, too, *Rufford v. Bishop*, 5 Rues, at p. 353).

It was, however, with mortgage transactions that SINGLETON, J., was concerned in the other two authorities upon which the Special Commissioners and LAWRENCE, J., relied in the present case. These two authorities were *Carnarvon (Earl) v. Inland Revenue Commissioners* and *Marland v. Inland Revenue Commissioners*. In the first of them the mortgagor agreed to pay interest on a named day in each year and it was agreed that if such interest were not paid on the due date it should be deemed to be a new loan and should be capitalised and added to the principal sum and should thenceforth carry interest. As each instalment of interest fell due the net amount thereof, after deducting income-tax was added by the lenders to the principal sum in accordance with the agreement. A question subsequently arose between the borrower and the Crown as to whether he had paid the interest in each year so as to be entitled to deduct it in computing his income for the purpose of surtax. SINGLETON, J., held that the interest had been paid. He said (19 Tax Cas., at p. 465): "Under the loan agreement interest was payable. True, the interest was in fact capitalized. That was done as a result of the provision of the agreement as to what should happen if the interest was not paid on the due date. I find it difficult to draw a distinction between such a case and the method in which the account was kept by the bank in *Holder's Case*; and it seems to me that the same reasoning applies as that of ROMER, L. J., which I have already cited (100 L.J.K.B., at p. 447; [1931] 2 K. B., at p. 100; 16 Tax Cas., at p. 660): 'The company must be deemed to have paid each

half-year the accruing interest by means of an advance made for that purpose by the bank to the company'. It is true that that was a case as between banker and customer; but I do not see why, under the agreement in the present case, the appellant should not be deemed to have paid the interest by reason of an advance made for that purpose by the insurance company."

It is not material for the present purposes to consider whether or not the decision of the learned Judge can be supported upon other grounds. We are, however, for the reasons already given, unable to agree with him that the decision in *Holder's Case* justified his conclusion. The question before him was purely one of the proper construction to be placed upon an express agreement between a mortgagor and his mortgagee. That agreement provided in terms for the addition of interest to the capital sum as a new loan. We do not think that when that provision was carried into effect the mortgagor could properly be regarded as paying the interest out of the new loan.

The facts in *Marland's Case* were slightly different. The principal sum and interest chargeable annually were secured on a policy of insurance, and the loan agreement provided that compound interest was to be charged on all interest remaining unpaid for more than one month. The borrower was not to be personally liable for the payment of either principal or interest, but the borrower could, if he thought fit, pay the interest within one month after it fell due. He did not on any occasion pay the interest within one month after it fell due, and in each case the net amount was added to the loan by the mortgagees and interest thereafter was charged upon it. The same question arose between the borrower and the Crown as had arisen in *Lord Carnarvon's Case*, and was again decided by SINGLETON, J., in favour of the borrower upon the authority of *Holder's Case*.

In our opinion that decision cannot be supported. In that case there was not even any provision for capitalisation of interest in the strict sense, but merely a provision for charging compound interest. There is not, in our judgment, any justification, either in principle or in authority, for treating the latter provision as one that involves a notional payment of the interest at each yearly or half-yearly rest as the case may be.

In these circumstances it is, in our opinion, impossible to treat the interest in the present case as having been paid by the mortgagor half-yearly out of the sums advanced to him for the purpose by the society.

But this by no means disposes of the matter. It is still necessary to examine the transactions between the parties for the purpose of seeing whether the respondents are persons by or through whom any payment of interest has been made within the meaning of rule 21 (2).

Turning once more to the rule, it will be seen that it imposes on every such person an obligation to deduct out of the interest a sum representing the tax thereon. It is plain that this does not necessitate the actual setting aside of cash to meet the tax. A deduction in account is sufficient. If, instead of paying the full amount of the interest the debtor pays to his creditor the interest less the tax, he has fulfilled his obligation, even though the payment exhausts his cash in hand or, if paid by cheque, leaves nothing standing to his credit at his bankers. So long as the net interest and no more reaches the hands of the creditors the Crown has no cause for complaint. Nor can the Crown be concerned with the form in which the net interest reaches the hands of the creditor. The creditor may, if he thinks fit, agree to accept in full satisfaction of the net amount a bill or a bond or a chattel provided that the money value of what he gets in exchange does not exceed the net interest due. If this be so, a mortgagor and a mortgagee may validly agree that, in the event of failure by a mortgagor to pay the net interest as it falls due, the mortgagee will from time to time accept in full discharge of the mortgagor's liability to pay it, a capital charge for a like amount upon the mortgage security. As and when each charge takes effect the tax will have been deducted within the meaning of the rule, for the capital charge merely takes the place of a payment by the mortgagor of the net amount and can never exceed that net amount in money value.

In our judgment the arrangement that was made between the mortgagor and the society in the present case was of that nature. It is true that by the deeds of mortgage and further charge the mortgagor covenanted to pay the full rate interest. But whether such interest was payable out of profits and gains brought into charge or not, the mortgagor could not have been compelled by the mortgagee to pay more than the net amount. When, therefore, it was provided by clause 5 (B) of the mortgage deed that if any interest should not be paid on any half-yearly day appointed for its payment, or within thirty days thereafter, the sum due in respect of the half-year's interest so unpaid should be converted into and become principal money, the sum due must mean the net amount of the interest after deduction of tax. The thing that is

to be converted into principal money is the sum that could otherwise have been recovered from the mortgagor; that is the net amount. In this connection it is to be noticed that it is not "the interest" that has to be converted into principal money but "the sum due", a change of language that must have been intentional. In our opinion, in each half-year that net interest was added to the capital the mortgagor deducted the tax as required by rule 21 and the society accepted the capital charge in full satisfaction of the interest after such deduction had been made. This being so, when the respondents paid to the society out of the purchase-money the sums that had been so added to the principal moneys secured they were paying a sum that had already suffered tax, and were under no liability to make any further deduction. It is plain that such a sum is not interest within the meaning of the rule.

In these circumstances it is unnecessary to express any opinion upon the question whether, in view of the respondents' position in the matter, they could in any case be properly described as persons by or through whom the interest had been paid.

The appeal fails and must be dismissed with costs.

Appeal dismissed.

Solicitors: *Solicitor of Inland Revenue*, for the Appellants.

Lawrence, Graham and Co., for the Respondents.

[IN THE KING'S BENCH DIVISION].

TRUSTEES OF WERNHER'S CHARITABLE TRUST

v.

COMMISSIONERS OF INLAND REVENUE.

LAWRENCE, J.

March 18, 19, 1937

CHARITABLE PURPOSES—RECREATION GROUND FOR EMPLOYEES OF A COMPANY—WHETHER CHARITABLE PURPOSE—EXEMPTION—BENEFIT TO SECTION OF THE PUBLIC, MEANING OF.

A company which employed about 1,400 persons conveyed a certain area of land to the National Playing Fields Association to be held in trust as a playing field and recreation ground for the benefit of the company's employees. During the year 1933, the Appellant Trust, which had been admittedly founded for charitable purposes spent a considerable sum in putting up a pavilion and tennis courts on the land and claimed that the sum so spent by it was spent for 'charitable purposes' and was therefore exempt from tax: Held, that as the money in question was spent not for the benefit of a recreation ground for the public at large but only for the employees of a particular company, it was not expended for charitable purposes only.

There is a valid distinction for this purpose between a particular section of the public at large which arises from their residence in a particular locality and a particular section of individuals which is created by a selection of a public company.

Cases referred to:

CHRISTCHURCH (38 Ch. D. 520).

DRUMMOND ASHWORTH *v.* DRUMMOND *In re* [1914] (2 Ch. 90).

GOOD, *In re* [1905] (2 Ch. 60).

GOODMAN *v.* MAYOR OF SALTASH (7 App. Cas. 633).

HADDEN, *In re* [1932] (1 Ch. 133).

GRAY, TODD *v.* TAYLOR *In re* [1925] (Ch. 362).

MELLODY, BRANDWOOD *v.* HADEN *In re* [1918] (1 Ch. 228).

Mr. C. R. R. Romer, appeared as Counsel for the Appellants.

The Attorney General (Sir Donald Somervell, K. C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT.

LAWRENCE, J.—In this case certain land at Luton was conveyed to the National Playing Fields Association as trustees, to be held for the benefit in the first instance of the employees of the Electrolux Company, Limited, as a recreation field. During 1933 sums of money were expended by the appellants to provide equipment for recreational purposes on this land. The question I have to decide is whether those sums are liable to income-tax, or are exempt as being sums expended for charitable purposes only under Section 37 (1) (b) of the Income-tax Act, 1918. The Commissioners have held that the purposes are not charitable, and I am in agreement with them.

It has been argued on behalf of the Appellants that the recreation ground of a public company like Electrolux, Limited, is a public purpose, a purpose for the good of the community, on the

ground that industry and what may be called the industrial army are just as important to the community at large as the military army. Reliance is placed upon the well-known cases as to charitable trusts of *In re Good*, (1905) 2 Ch. 60, where it was held that money bequeathed to help in providing a library for a particular regiment in the Army, tending as it did to the efficiency of the Army, was charitable, as being a trust or gift for the benefit of the community at large. Similarly in the case of *In re Gray, Todd v. Taylor* a gift for the support of the Carabiniers was held to be a good charitable gift, on the ground that it benefited the public by benefiting the Army. Reliance was also placed upon *In re Hadden* which was a case where money was bequeathed for recreation. That was held to be a good charitable trust, for the ground that recreation is good for the public, tending as it does to develop the health of the public.

Secondly, it was argued for the Appellants that the money in this case has been expended for the benefit of a particular section of the public. Reliance was placed upon *Goodman v. Mayor of Saltash* 7 App. Cas. 633 and the passages at page 642 and page 650—that was a case of freemen of a particular area who were entitled, under a supposed grant, to an oyster fishery during certain months of the year—and upon the *Christchurch* case which followed the *Saltash* case, and which dealt with a trust for the benefit of free cottagers in the neighbourhood of Christchurch; and lastly, on this head, upon the case of *In re Mellody, Brandwood v. Hadden* where a gift was upheld as a charitable trust for the benefit of the school children of a place called Turton.

On the other hand, the Attorney-General contends that the case is really on all fours with *In re Drummond*. That was a case where money was bequeathed for the purpose of contributing to the holiday expenses of work people employed in the spinning department of a certain company in such manner as the majority of the directors in their discretion thought fit. That was held by EVR, J., not to be a good charitable trust.

In my judgment this case falls to be decided in this Court in accordance with the judgment of EVR, J., in *In re Drummond*, the facts being in my opinion indistinguishable. It is perfectly true, of course, that the physical recreation of the public, and of any particular section of the public, does confer some benefit upon the community. In the case of *In re Hadden*, where the trust had been for the provision of a recreation ground for the public, it was held to be a charitable trust. But in *Drummond's* case, and in the

present case, the money in question is to be expended, and has been expended, not for the purpose of providing or equipping a recreation ground for the public at large, but only for the employees of Electrolux, Limited. The ground upon which *In re Good* and *In re Gray, Todd v. Taylor* were decided, in my opinion, was that the Army was of such importance to the public that any money which was expended for the benefit of the Army was expended in the interests of the community. But that does not apply to the present case, and I think the case of *In re Drummond* is a clear authority that that principle cannot be extended to what has been called the industrial army. If it could be so extended, I am unable to see how it could be limited in any way. It would, it seems to me, be equally true to say that it was in the interests of the public at large that the physical recreation of any individuals should be promoted, as that the physical recreation of employees of a particular company should be promoted.:

On the second head of Mr. Romer's argument that the employees of Electrolux, Limited, are a particular section of the public, and that anything done for the benefit of that particular section is a good charity, there seems to me to be a valid distinction between a particular section of the public at large which arises from their residence in a particular locality, and a particular section of individuals which is created by a selection of a public company. The employees of a public company seem to me to be in a different position altogether from the freemen of a particular locality or the cottages of a particular locality, or the school children of a particular locality. I think, therefore, that the principles of *Goodman v. Mayor of Sultash* and the *Christchurch case* and *In re Melody* are inapplicable to the present case. I therefore hold, in accordance with the ruling of the Commissioners, that the money expended in this case was not expended for charitable purposes only.

The appeal must be dismissed with costs.

Appeal dismissed.

Solicitors: *Devonshire, Wreford-Brown & Co.*; Solicitor of Inland Revenue.

[IN THE MADRAS HIGH COURT.]

NARAYANAN CHETTIAR

v.

COMMISSIONER OF INCOME-TAX, MADRAS.

SIR LIONEL LEACH, C. J., MADHAVAN NAIR
and VARADACHARIAR, JJ.

October 26, 1938.

FOREIGN PROFITS—MONEY-LENDING BUSINESS—FOREIGN BRANCHES—REMITTANCE TO BRITISH INDIA—ASSESSABILITY—PROFITS IN ONE BRANCH AND LOSS IN ANOTHER—WHETHER ASSESSEE ENTITLED TO HAVE LOSS SET-OFF AGAINST PROFITS—INDIAN INCOME-TAX ACT (XI OF 1922), SEC. 4 (2).

Where an assessee carries on two money-lending businesses outside British India in close proximity both being his sole businesses having current transactions and controlled by him and where one of the two businesses has suffered loss and the other has profits and the assessee has received remittances from both, in determining whether the remittances so received are his income, profits and gains under Sec. 4 (2) of the Indian Income-tax Act the results of both the businesses should be considered together and the assessee is entitled to set off his loss in one business against the profits of the other business to arrive at the resultant profit available for remittance to be taxed.

LEACH, C.J.—*The decisions on the question whether a particular remittance represents profits or capital will turn on the particular facts of each case, but there can be no question of a remittance representing profits when no profits have been earned taking the business abroad as a whole.*

Case stated by the Commissioner of Income-tax, Madras, under Sec. 66 (3) of the Indian Income-tax Act (O. P. No. 118 of 1937) in pursuance of an order of the High Court dated 13th October, 1937 in the matter of the assessment of S. N. Narayanan Chettiar of Karaikudi for the Assessment year 1935-36.

CASE.

“As directed by the High Court in the above order, I have the honour to refer the following case for the decision of the Hon'ble Judges of the High Court under Sec. 66 (3) of the Indian Income-tax Act, XI of 1922 (hereinafter referred to as the Act).

2. The reference arises out of the assessment of S. N. Narayanan Chettiar (hereinafter referred to as the assessee) for the tax

year 1935-36 on the income of the Tamil year *Bhava* ended 13th April 1935.

3. The assessee is the manager of a Hindu undivided family residing at Karaikudi within the jurisdiction of the Income-tax Officer, Karaikudi I Circle, and deriving income from property and money-lending business at Karaikudi (headquarters) in British India and at Ipoh and Telukanson outside British India. Both of these last-mentioned places are situated in the Federated Malay States at a distance of 50 miles from each other. The assessee is also a partner on behalf of the family in a firm at Kuala Lumpur and in another at Sitiawan (in the Federated Malay States).

4. For the tax year 1935-36 the assessee was assessed on a total income of Rs. 20,515 which included a sum of Rs. 20,000 representing remittances of profit from Telukanson. It was found that during the year *Bhava* (1934-35) the business at Telukanson had made a profit of 16,047 dollars and that at Ipoh had suffered a loss of 6,598 dollars. There were remittances amounting to 12,854.50 dollars (Rs. 20,000) from Telukanson and 1,954.48 dollars from Ipoh to British India. In view of the absence of profits at Ipoh, the Income-tax Officer did not include the amount received from that place in the assessment. He, however, held that the remittances from Telukanson were liable to be taxed as they had evidently been made out of profits derived at that place. The assessee contended that in calculating the profits available at Telukanson the losses of Ipoh should be taken into account as both the businesses were branches of the business at headquarters and there were current transactions between the two branches. It is true that there were current transactions in the course of business between Ipoh and Telukanson and that Ipoh always remained a debtor to Telukanson. There was, however, no evidence to show that these businesses were interdependent on each other or that one was a branch of the other. On the contrary, such evidence as there was indicated that the businesses at Telukanson and Ipoh were independent of each other. It was found that each was in charge of a different agent who acted independently of the other and whose bonus was determined solely with reference to the results of the respective businesses managed by him, that the two agencies were closed on different dates and for different periods and that the profits or losses of either business were not incorporated in the accounts of the other. On these facts and in the absence of any evidence to the contrary the Income-tax Officer concluded that the two businesses were entirely separate, that the

profits or losses of each should be considered separately and that the losses of Ipoh could not be set off against the profits of Telukanson. He also found that there were sufficient profits at Telukanson to cover the remittances of 12,854 dollars (Rs. 20,000) in the year, and accordingly treating them as remittances of profits included them in the assessment.

5. On appeal the Assistant Commissioner accepted the Income-tax Officer's findings and confirmed the assessment. The assessee then required my predecessor to state a case to the High Court under Sec. 66 (2) of the Act, which he declined to do on the ground that no question of law arose. Copies of the orders of the Income-tax Officer, the Assistant Commissioner and my predecessor are filed, marked Exhibits A, B & C respectively.

6. The assessee thereafter moved the High Court under Section 66 (3) of the Act and the High Court has by its order dated 13th October 1937 directed me to state a case and refer the following question, which I accordingly refer, for the decision of the Hon'ble Judges of the High Court:—

“Where an assessee carries on two money-lending businesses outside British India in close proximity, both being his sole businesses having current transactions and controlled by him and where one of the two businesses has suffered loss and the other has profits and the assessee has received remittances from both, in determining whether the remittances so received are his income, profits and gains under Sec. 4 (2) of the Indian Income-tax Act XI of 1922, should not the results of both the businesses be considered together and is not the assessee entitled to set off his loss in one business against the profits of the other business to arrive at the resultant profit available for remittance to be taxed”?

7. Before giving my opinion I beg leave to summarise below the facts found in this case.

(i) The businesses at Telukanson & Ipoh belong solely to the assessee and are distinct from and independent of each other and are situated at places which are about 60 miles apart.

(ii) The business at Telukanson made a profit of 16,047 dollars during the “previous year” *Bhava* (1934-35).

(iii) There were remittances of Rs. 20,000 (12,854.50 dollars from Telukanson to British India which the Income-tax Officer assessed as remittances of profits and which are the subject matter of this reference.

(iv) The business at Ipoh suffered a loss of 6,598 dollars during the previous year *Bhava* (1934-35).

(v) There was a remittance of 1,954.48 dollars from the Ipoh business to British India which the Income-tax Officer did not assess on the ground that the business had suffered a loss.

(vi) The assessee was a partner in two other foreign businesses, one at Sitiawan and the other at Kulalampur. There were no remittances from these two businesses to the assessee in British India during the year. The result of the working of these two businesses was not ascertained by the Income-tax Officer as there were no remittances. According to profit and loss accounts filed by the assessee in respect of the Sitiawan concern for the years 1931-32 to 1934-35 the profits there amounted to more than 12,000 dollars the profits for 1934-35 being 3,911.98 dollars.

(vii) There were current dealings between Telukanson and Ipoh. During the year of account *Bhava* (1934-35), the result of which year's working alone has been taken into consideration in this assessment Telukanson had sent sums amounting to 4,336 dollars to Ipoh and Ipoh had sent 6,069 dollars to Telukanson in the course of business.

8. From the question as it is worded it would seem as though the remittances received in British India from both Ipoh and Telukanson have been assessed. This is not correct so far as the assessment out of which this reference arises is concerned. The Ipoh remittances I may say have recently been taxed in pursuance of assessment proceedings started by the Income-tax Officer under Sec. 34, but that is a separate matter having no bearing on the point at issue in this reference and is therefore one with which the Court is at present not concerned. In the assessment now under consideration, as I have pointed out already, the remittances from Ipoh has been ignored by the Income-tax Officer as there were no profits there. That assessment is confined to the remittances from Telukanson only where there were profits.

9. Having cleared this point, I must proceed to state that there is nothing in the provisions of the Act to warrant the view that in determining the amount of profits available for remittance to British India at one foreign concern regard should be had to the loss suffered by another independent foreign concern, so that the loss in the latter should be set off against the profit in the former. Ipoh being an independent business, its loss does not as a matter of accountancy or practice fall to be deducted from the Telukanson profit in the preparation of the profit and loss account of the latter concern. The only grounds therefore on which any

claim to deduct the Ipoh loss can possibly be based are (1) that it is a loss which must be set off under the provision of Section 24 (1) of the Act or (2) that part of the Telukanson profit was in fact sent to Ipoh to make good the loss at that place, thus reducing the quantum of profit available at Telukanson for remittance to British India, or (3) that as a matter of law in deciding how much of any sums remitted from abroad came out of profits available for remittance a comparison should be made with the profits and losses of all the foreign concerns taken together irrespective of whether the remittances came from out of the funds of one or more or all of the foreign concerns.

10. If Ipoh were in British India there would be no difficulty at all in the application of Section 24 (1) to the loss. That loss would be one accruing or arising in British India and would automatically come into the computation of the assessee's total income. But Ipoh *is not* in British India. It is a foreign concern. The question therefore arises whether that fact makes any difference. The assessment of the foreign profits of a person resident in British India is governed by Section 4 (2) of the Act which lays down that income, profits and gains accruing or arising without British India to a person residing in British India shall, if they are received in or brought into British India, be deemed to have accrued or arisen in British India and to be income, profits and gains of the year in which they are so received or brought. Thus the profits of a foreign business do not begin to attract liability to tax unless and until they are received in or brought into British India. Now how does the Act apply to a loss in a foreign concern? The main part of Section 4 (1) of the Act, I submit, does not apply as the loss obviously does not accrue or arise in British India nor can it be said to be received in British India. Can it be said to be *deemed* to accrue or arise or be received in British India under the provisions of Section 4 (2)? Here again I submit that it cannot. In my humble opinion therefore a loss in a foreign concern cannot be regarded as a loss falling to be dealt with under Section 4 (1) or Section 4 (2) read with Section 24 (1) in the computation of a person's total income for assessment to income-tax. If a foreign loss were to be allowed to be set off under Section 24 (1) then every such loss would be allowable even when there may be no remittances from abroad at all. Such a state of affairs is surely not contemplated by the provisions of the Act already referred to and as a matter of fact no person has to my knowledge ever seriously made such a preposterous claim.

11. I now turn to the alternative ground on which the claim to deduct the Ipoh loss can be based. It is possible in the circumstances stated towards the end of paragraph 9 above for a loss in one foreign concern to affect the amount of profit available for remittance in another foreign concern. But this has not happened in the present case. On the evidence of the accounts there was a profit of 16,047 dollars, at Telukanson. The amount remitted was less than this, *i.e.*, 12,854 dollars (or Rs. 20,000 in Indian currency). The question is how much of the remittance was profit. The answer to this depends on how much profit was available for remittance at Telukanson. If the assessee could have shown that any part of the above profit had been drawn upon to meet losses incurred at Ipoh then it might have been possible to hold that the amount of profit available at Telukanson had been reduced *pro tanto*. But there is nothing to show that this had been done. There were no doubt current dealings between Ipoh and Telukanson. But there is nothing in the course of those dealings to indicate that any part of the profit at Telukanson had been utilised for meeting the losses at Ipoh. On the contrary, the probabilities are that the Ipoh concern did not even stand in need of any such help from Telukanson, as, in spite of the loss incurred, Ipoh sent to Telukanson a larger amount than it received from Telukanson in the year, and it was also found possible to remit 1,954.48 dollars from Ipoh to British India. In the circumstances there can be no question of setting off the whole or any part of the Ipoh losses against the Telukanson profits to determine the amount of Telukanson profits available for remittance.

12. If the third ground set out at the end of paragraph 9 above, were to be accepted as good law, it would amount to setting up the theory that in the computation of the quantum of foreign profits available for remittance there should be an aggregation of the profits and losses of all the separate foreign businesses in which a person is concerned either as owner or as partner. In this case for example the Income-tax Officer would have been justified in including the profits of the businesses at Sitiawan and Kulalampur in the computation of the amount available for remittance and setting off against it the losses incurred at Ipoh. This is certainly not what the assessee wants and it is clear that he has not based his claim on this ground. In any case I submit that the law does not permit of either the aggregation of profits or the setting off of the losses of different foreign businesses when they are independent concerns without any close connection with each other.

13. For the reasons set out above I request that the Court will be pleased to answer the question propounded in the negative.

R. Kesava Aiyangar, for the Assessee.

M. Patanjali Sastri, for the Commissioner.

JUDGMENT

LEACH, C. J.—The assessee in this case is a Nattukotai Chettiar. He carries on a money-lending business at Karaikudi in the Madras Presidency and at Ipoh and Telukanson in the Federated Malay States. Ipoh and Telukanson lie some fifty miles distant apart. During the year 1934-35 the business at Telukanson showed a profit of 16,047 dollars but that at Ipoh showed a loss of 6,598 dollars. In respect of the year 1935-36 the assessee was assessed on a total income of Rs. 20,515 which included a sum of Rs. 20,000 remitted to Karaikudi from Telukanson. The Income-tax Officer treated this as a remittance of profits of a foreign business. In addition to the Rs. 20,000 remitted from Telukanson a sum of 1,954.48 dollars was remitted from Ipoh. In view of the absence of profits at Ipoh the Income tax Officer did not include the 1,954.48 dollars in the assessment. The assessee contended that the sum of Rs. 20,000 remitted from Telukanson should not be treated wholly as profits. He said that the proper method of calculating the profits of his business abroad was to deduct the loss suffered at Ipoh from the profits made at Telukanson. As the assessee had an agent at each of the two towns and the two branches worked independently of each other the Income-tax Officer held that the profits and losses of the two branches should be considered separately, and consequently refused to allow the loss at Ipoh to be set off against the profits at Telukanson. The Assistant Commissioner of Income-tax agreed with the Income-tax Officer when the matter was before him on appeal, and the Commissioner of Income-tax refused to state a case to this Court under Section 66 (2) of the Income-tax Act, on the ground that no question of law arose. This Court, however, considered that a question of law did arise and directed the Commissioner to refer to us the following question:—

“Where an assessee carries on two money-lending businesses outside British India in close proximity, both being his sole businesses having current transactions and controlled by him and where one of the two businesses has suffered loss and the other has profit and the assessee has received remittances from both, in determining whether the remittances so received are his income,

profits and gains under Section 4 (2) of the Indian Income tax Act XI of 1922, should not the results of both the businesses be considered together and is not the assessee entitled to set off his loss in one business against the profits of the other business to arrive at the resultant profit available for remittance to be taxed?"

In our opinion this reference must be answered in the affirmative. Section 4 (2) of the Act allows the Income-tax Officer to assess to income-tax income, profits and gains arising out of British India, but in deciding whether sums which are brought in from a business abroad are income, profits or gains, he must have regard to the business as a whole. When a person carries on the same kind of business in two places abroad, in order to ascertain whether he has made a profit the result of the working of the two branches must be considered. If at one branch he makes a profit and at the other a loss the profit in his business can only be the gain made at one branch less the loss suffered at the other branch. So far as this case is concerned we know that at one of the branches a profit was made and at the other place a loss was suffered. When the loss in one case is set off against the profit in the other it is clear that the assessee did not make a profit of Rs. 20,000. His profits at Telukanson stated in dollars were 16,047 dollars and his loss at Ipoh amounted to 6,598 dollars. The profit was therefore 9,449 dollars. It was only to this extent that the Income-tax Officer could hold that the remittance was out of profits. The decision on the question whether a particular remittance represents profits or capital will turn on the particular facts of each case, but there can be no question of a remittance representing profits when no profits have been earned taking the business abroad as a whole.

The reference having been answered in favour of the assessee there will be an order for costs in his favour. These we fix at Rs. 250. His deposit will also be refunded.

Reference answered in favour of the assessee.

[IN THE MADRAS HIGH COURT.]

CHIDAMBARAM CHETTIAR, M. S. S. & ANOTHER

v.

COMMISSIONER OF INCOME-TAX, MADRAS.

SIR LIONEL LEACH, C. J., MADHAVAN NAIR, J., and

VARADACHARIAR, J.

November 1, 1938.

FOREIGN PROFITS—REMITTANCE TO BRITISH INDIA—COMPUTATION OF PROFITS AVAILABLE FOR REMITTANCE—PROFITS RECEIVED IN THE SHAPE OF LANDS—WHETHER TO BE EXCLUDED—INDIAN INCOME-TAX ACT (XI of 1922), Sec. 4 (2).

During the year 1933-34 the assesseees who were partners in a firm in Ipoh in the Federated Malay States remitted from Ipoh to British India moneys amounting in the aggregate to Rs. 99,279. The total profits of the Ipoh firm for the years 1930-31 to 1933-34 amounted to 1,27,806 dollars and the assesseees' share therein was 1,19,647 dollars. But a sum of 74,750 dollars of the profits of the firm represented interest received not in cash but by taking over lands from the debtors, and the assesseees contended that in determining whether the remittance to British India was out of profits, this sum must be excluded as it represented immovable properties and was not in a remittable form: Held, on a reference by the Commissioner, that the sum of 74,750 dollars should not be excluded from the amount of profits of the firm in computing the profits available for remittance. The withdrawals from the firm must be treated as withdrawal of profits, and the immovable properties representing profits must be deemed to have been turned into capital assets.

Scottish Provident Institution v. Allan [1903] (4 Tax Cas. 591; 1903 A.C. 129) applied.

Case stated by the Commissioner of Income-tax, Madras, under Sec. 66 (3) of the Indian Income-tax Act in pursuance of an order of the High Court dated October 28, 1937, in the matter of the assessment of an undivided Hindu family for the year 1934-35—(O. P. No. 176 of 1937).

CASE.

“In the above order, the High Court has directed me to refer to it a question of law arising out of the assessment of the Hindu

undivided family of M.S.S. Chidambaram Chettiar and Meyyappa Chettiar of Karaikudi for the year 1934-35.

2. The family resides at Karaikudi within the jurisdiction of the Income-tax Officer, Karaikudi I Circle, and carries on money-lending business at Karaikudi (headquarters) and Rangoon (which in the relevant years was within British India) and at Saigon outside British India. It is a partner with a $\frac{1}{2}$ share in the M.S.M.S. firm, Singapore, with 15 out of 21 shares in the M.S.S. firm, Ipoh, and with 19 out of 30 shares in the S.M.C.T. firm, Kangyidaung in Burma. It also derives income from property and dividends.

3. For the year 1934-35, the Income-tax Officer, Karaikudi I Circle, assessed the family on a total income of Rs. 98,614. On appeal the Assistant Commissioner reduced it to Rs. 97,574. The following are the details of this figure:—

		LOSS.	PROFIT.
		Rs.	Rs.
I. Property.	...		5,682
II. BUSINESS.			
(a) Headquarters (sole business)		787	
(b) Rangoon do.	...	4,401	
(c) Remittance from M. S. S. Saigon (sole business)	...		5,165
(d) Share in S. M. C. T. Kangyidaung (partnership concern).		12,146	
(e) Remittance from M.S.S. Singapore (partnership concern).			4,612
(f) Remittances from M. S. S. Ipoh (partnership concern).			99,279
III. OTHER SOURCES.			
Dividends.	...		270
		17,334	1,15,008
Profit	Rs.	1,15,008	
Loss	... ,,	17,434	
Total income	Rs.	97,574	

The present reference is concerned with the sum of Rs. 99,279 being the remittances from M.S.S. firm, Ipoh—item II (f) above. The facts relating to this item are given below.

4. The accounts of the Ipoh firm showed that during the "previous year" (Tamil year *Srimuka* ended 12-4-34) it remitted a total sum of dollars 64,100 or Rs. 99,279 to the assessee in British India. The remittances were debited to the assessee's Rangoon business as shown below :—

12-6-33	By Mercantile Bank draft	Dollars	20,010·20
17-8-33	" "		12,954·18
	do. do. for money sent to Oorkadai		3,248·45
25-10-33	By adjustment from Karaikudi M. P. L. at Oorkadai		1,935·48
2-2-34	By telegraphic transfer to Mercantile Bank		6,009·20
21-3-34	By Mercantile Bank draft		20,007·54
Total			Dollars 64,160·01

The total profits of the Ipoh firm for the 4 years 1930-31 to 1933-34 amounted to dollars 1,27,806. Of this, the assessee's share was dollars 1,19,647. There is no dispute as regards the correctness of these figures or of the amount of the remittances. The point of difference between the assessee and the department is in respect of the quantum of profits *available* for remittance. In working out the profits of the firm, a sum of dollars 74,570 representing interest realised in the discharge of loans by lands being taken over from the debtors was included as income received. The assessee contended before the Income-tax Officer that this sum must be excluded from the profits for the purposes of computing the amount available for remittance as the interest was realised in the shape of lands and was therefore not in a remittable form. The Income-tax Officer overruled the contention for the following reasons :

(1) The Act has not laid down a distinct method of computation of profits for the purposes of the application of Section 4 (2) of the Act. The method prescribed under Secs. 10 and 13 should be followed for determining the profits available for remittance.

(2) The interest realised in the shape of lands is not by itself profit. It is only a gross receipt and is only one of the several items that are taken into account in the profit and loss statement for ascertaining the net profit or loss. It does not retain its original character in the *net profits* of the firm available for distribution amongst the partners.

(3) The total income receipts in the 4 years amounted to dollars 2,75,152 of which the interest realised in the shape of lands and by inclusion in renewed promissory notes amounted to dollars 97,238. Even if this is left out of account there were actual receipts in cash far in excess of the remittances (dollars 64,160).

(4) The expenses should be regarded as a charge on the whole gross receipts including the interest included in renewed promissory notes and realised in the shape of lands.

5. The Assistant Commissioner agreed with the Income-tax Officer and held that the properties taken over from the debtors should be regarded as having been purchased out of other funds of the business as it was a mere matter of adjustment in the books. He took up this position because the remittances had been sent out of the cash in the business. He also observed that the capital of the business to the extent of the value of the immovable properties taken over from the debtors in lieu of interest should be regarded as having been represented by the immovable properties and that a like amount of interest or profits should be regarded as being available for remittance and as having been remitted.

6. The assessee then filed an application under Sec. 60 (2) before my predecessor raising various questions arising out of the assessment. My predecessor declined to state a case to the High Court on the ground that no question of law arose. Extracts from the orders of the Income-tax Officer, the Assistant Commissioner and my predecessor are filed marked Exhibits A, B and C respectively. The assessee thereupon moved the High Court under Sec. 66 (3) and the High Court has by its order dated 28th October 1937 directed me to state a case and refer the following question which I accordingly refer for the decision of the Hon'ble Judges of the High Court :

"The total profits of the assessee for the years 1930-31 to 1933-34 having been found to be dollars 1,19,649, of which dollars 74,570 represents immovable properties taken over by the assessee from their debtors, should the Income-tax Officer in computing the profits available for remittance from the Ipoh firm have excluded the sum of dollars 74,570 ".

7. Before giving my opinion I should like to point out a slight error in the wording of the question. The sum of dollars 1,19,647 is the assessee's *share* of the profits of the Ipoh firm, whereas the sum of dollars 74,570 is the *total* amount of interest realised by the *firm* of which the assessee's share is only 5/7 or dollars 53,264.

8. The question as to the quantum of profits available in a remittable form loses much of its force when it is remembered that the assessee is only a partner in the Ipoh firm and that he is entitled to get his share of profits from the firm, no matter how the firm decides to raise the necessary funds. The firm may pay the partner's share of profits out of any funds available with it. He is not directly concerned with the manner in which the funds from which his share of profit is paid are found. The character of the money received by the partner towards his profits will not be affected by the character of the source from which the firm found the wherewithal to pay it. The receipt by a partner of his share of profits from the firm is analogous to the receipt of dividend by a share-holder from a Company. So long as there is a surplus in its revenue account a Company may pay dividends to its share-holders out of any funds available with it. Such dividend will be regarded as paid out of the profit of the Company irrespective of the source from which the Company pays it.

9. Apart from this, the argument that an amount remitted can be regarded as profit only if an equivalent amount of profit is available in cash is not at all sound. In actual business experience such a thing will be found impracticable. No business concern can afford to keep its profits always available in cash. Profits will for the most part be represented by some assets of the business other than cash. In a trading concern, the bulk of its profits may be in the shape of stock; all the same there would be profits. The fact that the assets representing the profits have not been turned into cash will not prevent a Company from distributing dividends. In ordinary commercial concerns the profits available for distribution are represented by the amount which stands to the credit of the business in its Profit and Loss account. Generally speaking they are measured by the excess of receipts over the expenses shown in the Revenue account. Where it is provided in the Articles of Association of a Company that the profits arising out of the business may be divided, such sum as represents the credit balance of the revenue account can be distributed as profits *out of any funds* available with the Company.

10. In the present case certain lands were acquired in the course of the business. These lands may form part of the stock-in-trade of the business if the assessee holds them merely for purposes of re-sale, or they may become capital assets if there is no intention to sell. As stock in-trade these lands cannot be regarded

in any manner different from any other form of stock-in-trade so as to affect the availability of profits for distribution. If on the other hand they are to be treated as capital assets the proper way to regard the transactions involving the acquisition of these lands is to hold that, as capital assets were acquired the expenditure incurred thereon must have come out of capital rather than out of profit. In my humble opinion therefore the Income-tax Officer was right when he said that interest realised in the shape of lands taken over from the debtors could not be regarded as *profit sunk in land*.

11. I have already stated that the profit of a concern represents the excess of receipts over expenses. An examination of a Profit and Loss account will show that interest is an item, perhaps one of the several items, of gross receipts on the credit side of the account. Out of this the several expenses shown on the debit side have to be met. The net profits as shown by the Profit and Loss account cannot therefore be said to comprise the whole interest as such. The assessee's share of profits, *viz.*, dollars 1,19,647 is net profit. The sum of dollars 5,32,64 referred to in paragraph 7 above is gross profit and not net profit. The two figures are therefore not comparable. To make them so, the proportionate expenditure incurred in earning the gross profit of dollars 53,264 should be deducted.

12. The assessee had also objected before the Income-tax Officer and the Assistant Commissioner to the inclusion of the interest included in renewed promissory notes in the computation of the available profits and the Assistant Commissioner allowed the contention. Although no question arises in the present reference in regard to this matter I think I should state here that I consider that the Assistant Commissioner was wrong in allowing it. Such interest is undoubtedly an income receipt according to the method of accounting followed by the assessee and should have been taken into account in arriving at the profit available for distribution amongst the partners.

13. Even if the point raised in the question be conceded in favour of the assessee, he will not be entitled to any relief in respect of the assessment for 1934-35 which is the one now under consideration as the remittances assessed are only dollars 64,160 whereas the profits available for remittance excluding the assessee's share of interest realised in the discharge of loans by the taking over of lands is dollars 66,883 (dollars 1,19,647 *minus* dollars 53,264 which is more than the remittances assessed. But in O. P.

No. 175/37 (assessment for 1933-34) and in O.P. No. 177/37 (assessment for 1935-36) the assessee may derive some benefit if the question raised by him is answered in his favour.

14. For the reasons given in paragraphs 8 to 11 above the question should in my opinion be answered in the negative."

M. Patanjali Sastri for the Commissioner.

JUDGMENT.

LEACH, C. J.—This reference arises out of an assessment of an undivided Hindu family the members of which are M. S. S. Chidambaram Chettiar and Meyappa Chettiar. The assesseees are partners in various money-lending firms in the Federated Malay States and in Burma, and carry on the same kind of business at Karaikudi where they have their headquarters. One of their foreign firms does business at Ipoh in the Federated Malay States. Owing to the financial depression which existed there this firm was compelled to take over in satisfaction of debts due to it immoveable properties which had been mortgaged as security for debts. The values of these immoveable properties were treated as representing in part the return of capital and in part profits. The total profits of the firm were calculated and it was found that they amounted to dollars 1,27,806 of which dollars 74,570 was represented by land. The assesseees' share in the sum of dollars 74,570 was dollars 53,264. During the year of account (1933-34) the assesseees remitted from Ipoh to Rangoon, which was then in British India, sums amounting in the aggregate to Rs. 99,279. These remittances the Income tax authorities treated as being remittances of profits. The assesseees objected to this, their objection being that the profits represented by immoveable properties were not capable of remittance. The Court directed the Commissioner of Income-tax under Section 66 (3) of the Act to refer the following question for decision :—

"The total profits of the assesseees for the years 1930-31 to 1933-34 having been found to be dollars 1,19,647 of which dollars 74,570 represent immoveable properties taken over by the assesseees from their debtors, should the Income tax Officer in computing the profits available for remittance from the Ipoh firm have excluded the sum of dollars 74,570?"

The Commistioner of Income tax rightly points out that there is an error in the wording of the question. The sum of dollars 74,570 was the total interest of the firm in immoveable properties and the assesseees' share, as I have already said, was only 53,264 dollars.

In our opinion the question referred must be answered in the negative. The assessee cannot be allowed to withdraw money from the firm and treat their interest in the immoveable properties of the firm as representing their profits. They accumulated profits to the extent of 1,19,647 dollars and out of the common funds of the firm they made the remittances. The withdrawals from the firm must therefore be treated as withdrawal of profits. The effect was to turn the immoveable properties representing such profits into capital assets. The case comes within the principle stated by the House of Lords in *Scottish Provident Institution v. Allan*.

As the answer is against the assessee they must pay the costs of the Commissioner of Income tax, Rs. 250.

Reference answered against the assessee.

[IN THE HIGH COURT OF MADRAS.]

COMMISSIONER OF INCOME TAX, MADRAS

v.

VALLIAMMAI ACHI.

SIR LIONEL LEACH, C. J., MADHAVAN NAIR, J., and

VARADACHARIAR, J.

November 1, 1938.

BURMA—LOSS SUSTAINED IN BURMA IN 1936-37—ASSESSMENT OF INCOME IN 1937-38—LOSS WHETHER ALLOWABLE—EFFECT OF SEPARATION OF BURMA FROM BRITISH INDIA—DEFINITION OF 'BRITISH INDIA'—RELATION BETWEEN FINANCE ACT AND INCOME TAX ACT—INCOME OF PREVIOUS YEAR, WHETHER MEASURE OF INCOME OR INCOME ACTUALLY ASSESSED—INDIAN LAW—INDIAN INCOME TAX ACT (XI OF 1922), SECS. 3, 4, 24—GOVERNMENT OF INDIA ACT, 1935—GOVERNMENT OF INDIA (ADAPTATION OF INDIAN LAWS) ORDER, 1937—FINANCE ACT, 1937.

The assessee had an income of Rs. 14,501 from investments in the year of account 1936-37. She had sustained a loss of Rs. 8,000 in the said year in a business carried on in Burma and she claimed that this amount must be set off against her income from investments. The department contended that as Burma had ceased to be a part of British India in the assessment year 1937-38, the set-off

could not be allowed : Held, on a reference by the Commissioner, that under Sections 3 and 4 of the Indian Income tax Act, tax was chargeable on the income received in what was British India during the previous year ; that under the Indian Act the income of the previous year was not merely a guide to the ascertainment of the income of the assessment year but the actual income to be assessed, and the loss sustained by the assessee in Burma in 1936-37 was accordingly allowable as a deduction even though the income was assessed only in 1937-38, after Burma ceased to be part of British India.

Though the Income Tax Act cannot be applied in any year until the Finance Act has been passed, it cannot be treated as a statute which is passed annually.

Cases referred to :

COMMISSIONER OF INCOME TAX, MADRAS V. KARUPPIAH KANGANI [1929] (55 M.L.J. 844).

BEHARI LAL MULLICK, *In re* [1927] (54 Cal. 680).

Case stated by the Commissioner of Income Tax, Madras, under Section 66 (2) of the Indian Income Tax Act, 1922, in the matter of the assessment of one Valliammai Achi for the assessment year 1937-38—[O. P. No. 105 of 1938].

STATEMENT OF CASE.

"At the instance of the assessee named above, I have the honour to refer the following case under Section 66 (2) of the Indian Income-tax Act (hereinafter referred to as the Act) for the decision of the High Court.

2. The petitioner Valliammai Achi is a resident of Pallathur within the jurisdiction of the Income-tax Officer, Karaikudi (II) Circle. For the year 1937-38 this Officer assessed her on a total income of Rs. 14,501 the whole of this being income from investments. The petitioner is the owner of a saw mill and carries on timber business at Gyobingauk in Burma. During the year of account (Tamil year *Dhathu*—year ended 12th April 1937) this business resulted in a loss of Rs. 8,668. She claimed a deduction of this amount from her income from investments, but the Income-tax Officer disallowed the claim on the ground that it was a loss incurred by a business outside British India.

3. The petitioner appealed to the Assistant Commissioner against the assessment. She objected to the disallowance of the loss on the following grounds:—

(1) The loss was incurred in British India as in the year in which it was incurred Burma formed part of British India.

(2) Income-tax is levied in respect of the income of the previous year and the intention of Section 3 of the Act is not to treat the income of the previous year merely as a measure of the income of the year of assessment but to tax an assessee in the year of assessment on the income received by him in the previous year.

4. The Assistant Commissioner however overruled the objection and upheld the Income-tax Officer's decision disallowing the loss. His reason was that as a result of the separation of Burma from British India with effect from 1st April 1937, the assessment for 1937-38 of the income, profits and gains accruing or arising in British India to a person resident in British India during the previous year 1936-37 should be made in accordance with the law as it stands at present in relation to Burma. In other words, he took Burma to be outside British India for the purposes of the Act in 1937-38, and held that as the loss was incurred outside British India it could not be set off against the income accruing, arising or received in British India.

5. The petitioner has now asked me to refer to the High Court the following question of law arising out of the Assistant Commissioner's order and I accordingly refer it.

"Whether the decision of the Assistant Commissioner that the loss of Rs. 8,663 incurred by the petitioner in Burma in the year of account 1936-37 is not allowable as a deduction in the year of assessment 1937-38 is correct in law".

6. The answer to this question depends on the effect of the definition of British India in clause (7) of Section 3 of the General Clauses Act, 1897, as amended by the Government of India (Adaptation of Indian Laws) Order, 1937, on the operation of sub-section (1) of Section 4 read with Section 3 of the Indian Income-tax Act, 1922. The combined effect of Section 3 and of sub-section (1) of Section 4 is to render British Indian income-tax for the year 1937-38 leviable in respect of the income, profits and gains which in the previous year accrued, arose or were received in British India and the point arising for determination is whether in these circumstances the reference to British India in sub-section (1) of Section 4 is for the purposes of the above cited definition of British India a reference to British India as respects the period before the commencement of Part III of the Government of India Act, 1935, (the 1st April 1937) or a reference to British India as respects a period after that date. In the former alternative the

quantum of income on which British Indian income-tax for the year 1937-38 falls to be assessed will include, while in the latter alternative it will exclude, income accruing, arising or received in Burma in the year 1936-37.

7. In my opinion the latter alternative is very clearly correct. The provision made in sub-section (1) of Section 4 read with Section 3 is a provision regulating the assessment to be made in and for the year following the previous year and it cannot be maintained that merely because the assessment is to be made on the income of the previous year the provision is one as respects the previous year. In the terms therefore of the definition of British India the reference to British India in sub-section (1) of Section 4 is a reference as respects the year following the previous year (here the year 1937-38) and therefore a reference as respects a period after the commencement of the Government of India Act, 1935. In my opinion therefore the loss in Burma in the year 1936-37 has been rightly disallowed and I desire to invite the attention of the Honourable Court to the fact that while in the present case the result of my view is unfavourable to the assessee the result in the vast majority of cases would be in the contrary direction, for if the Honourable Court holds in favour of the assessee in the present case it must follow of necessity that all income accruing, arising or received in Burma in the year 1936-37 is assessable to British Indian Income-tax for the year 1937-38."

Putanjali Sastri, for the Commissioner.

M. Subbaraya Aiyar, for the Assessee.

JUDGMENT.

LEACH, C. J.—The assessee who is a resident of Pallathur in the Madras Presidency owns a saw mill at Gyothingauk in Burma. In the account year, that is the year commencing from the 1st April 1936, the saw mill business resulted in a loss of Rs. 8,663 and her income consisted solely of interest received from investments. For the purpose of assessment to income-tax she sought to set off the loss sustained in the saw mill business against the profits from her investments. The Income-tax Officer refused to allow her to do so on the ground that on the 1st April 1937 Burma had ceased to be part of British India, and the loss having been sustained outside British India it could not be set off. On these facts the Commissioner of Income-tax has referred to the Court the following question:—"Whether the decision of the Assistant Commissioner that the loss of Rs. 8,663 incurred by the

Petitioner in Burma in the year of account 1936-37 is not allowable as a deduction in the year of assessment 1937-38 is correct in law?"

In order to appreciate the arguments advanced on behalf of the Income-tax authorities it is necessary to refer to the provisions of Section 3 and of Section 4 (1) of the Indian Income-tax Act. Section 3 is the charging section and it provides that where any Act of the Central Legislature enacts that income-tax shall be charged for any year at any rate or rates applicable to the total income of an assessee, tax at the rate or those rates shall be charged for that year in accordance with, and subject to the provisions of, the Act in respect of all income, profits and gains of the previous year of every individual, Hindu undivided family, company, firm and other association of individuals. Section 4 (1) states:—

"Save as hereinafter provided, this Act shall apply to all income, profits or gains, as described or comprised in Section 6, from whatever source derived, accruing or arising or received in British India or deemed under the provisions of this Act to accrue, or arise, or to be received in British India."

It is said that as the Income-tax Act does not come into operation in any year until the Finance Act has been passed, the Income-tax Act must be treated as a statute which is passed every year and the words "British India" must be deemed to mean British India as it stands at the time of the passing of the Finance Act and not what it was in the previous year. We do not accept this argument. It is true that the Income-tax Act cannot be applied in any year until the Finance Act has been passed but the Act cannot be treated as being a statute which is passed annually. It is a permanent enactment but it may not be enforced in any particular year until the Finance Act has been passed. Section 4 cannot be divorced from Section 3, and as Section 3 charges the tax on the income of the previous year it must, we consider, be charged on the income received in what was British India during the previous year. In *Commissioner of Income-tax, Madras v. Karuppiah Kangani alias Kumaravelu Ambalam* a Full Bench of this Court held that under the Act the income of the year previous to the year of assessment is not to be taken as merely a guide to the ascertainment of the income of the year of assessment but as the actual sum which is subject to taxation. This decision followed a decision of the Calcutta High Court to the same effect—*In re Behari Lal Mullick*.

When the assessee in this case sustained the loss on the working of her saw mill in Burma, Burma was part of British India, and

if Section 3 and Section 4 (1) are to be read together, as in our opinion they must be, the loss must be deemed to have been sustained in British India. Therefore the answer we give to the question referred is that the decision of the Assistant Commissioner in not allowing the deduction is not correct in law. The assessee is entitled to her costs Rs. 250 and to the refund of her deposit of Rs. 100.

Reference answered in favour of assessee.

[IN THE MADRAS HIGH COURT.]

MUTHAPPA CHETTIAR, E. M.

(Son of Visvanathan Chettiar)

v.

COMMISSIONER OF INCOME TAX, MADRAS.

SIR LIONEL LEACH, C.J., MADHAVAN NAIR, J.,

and VARADACHARIAR, J.

October 26, 1938.

RE-ASSESSMENT—INCOME ESCAPING ASSESSMENT—POWER OF INCOME TAX OFFICER TO RELY ON FACTS COMING TO HIS NOTICE AFTER ONE YEAR FROM END OF YEAR OF ASSESSMENT—INDIAN INCOME TAX ACT (XI OF 1922), Section 34.

Where the Income tax Officer has issued a notice under Section 34 of the Indian Income Tax Act, he can for the purpose of assessing income which has escaped assessment rely on facts which came to his knowledge after one year from the end of the year of assessment.

Case referred to :

RAJENDRANATH MUKHERJI v. COMMISSIONER OF INCOME TAX, BENGAL [1934] (1934 I.T.R. 71; 38 C.W.N. 819; A.I.R. 1934 P.C. 30; 61 Cal. 285; 7 I.T.C. 143).

Case stated by the Commissioner of Income Tax, Madras, under Section 66 (3) of the Indian Income Tax Act, 1922, in pursuance of an order of the High Court dated October 13, 1937, in the matter of the assessment of one E. M. Visvanathan Chettiar.

STATEMENT OF CASE.

"In accordance with the High Court's order.....I have the honour to refer the following case for the decision of the Hon'ble Judges of the High Court under Section 66 (3) of the Indian Income tax Act, XI of 1922 (hereinafter referred to as the Act).

2. The reference arises out of the assessment of E. M. Viswanathan Chettiar (hereinafter referred to as the assessee) for the tax year 1932-33 under Section 34 on the income of the Tamil year *Prajothpathi* ended 12th April 1932.

3. The assessee was the managing member of a Hindu undivided family residing at Pudukkottai within the jurisdiction of the Income tax Officer, Karaikudi I Circle. He is now dead, and is represented by his son, Muthappa Chettiar. The family carries on money-lending business at Pudukkottai (its headquarters) in British India and at Klang and Penang outside British India and is a partner in the E. M. firm, Moulmein (Burma). It also derives income from property, interest on securities and dividends.

4. For the tax year 1932-33 the family was originally assessed on 18th November 1932 on an income of Rs. 8,277 from the money-lending business. Subsequently, in the course of the assessment for 1933-34, the Income tax Officer discovered from the day-book copies of the E. M. firm, Moulmein (in which the assessee was a partner and which in turn was an assessee on the file of the Income-tax Officer, Moulmein), that the family had invested its moneys in the names of other persons and that the interest on such investments had escaped assessment in the past. Among others, there were investments in the names of the following persons:—(1) Valayapatti R.M.A.P.R. (2) Valayapatti R.M.K.T. Muthuraman Chettiar. The Income tax Officer instituted proceedings under Section 34 for 1932-33 by issuing a notice on 13th December 1933. He also wrote to the Income-tax Officer, Moulmein, asking him whether the interest on the above investments had been disallowed in the assessment of the E.M. firm and suggesting the re-opening of the assessment of the firm for 1932-33 under Section 34 if the interest had not been disallowed. The Income-tax Officer, Moulmein, replied finally to this reference in September 1934, stating that the interest in question had been *allowed* in the assessment of the firm for 1932-33. In the meantime the assessee had been given extensions of time for the submission of the return. On 6th October 1934 he filed a return in which he stated that no income had escaped assessment. On 25th February, 1935, a notice under Section 23 (2) was served on the assessee by which he was required to produce evidence in support of his return on 5th March 1935. His agent appeared on 5th March 1935 and asked for time to file a statement from the assessee. This was granted. On 27th March 1935 the assessee filed a statement to the effect that the interest on the deposits in question had

been assessed in the hands of the persons to whose credit the money stood in the books of the E.M. firm. In order to verify this statement the Income-tax Officer made a reference to the Income-tax Officer, Moulmein, on 11th April 1935. His reply, which was received on 8th May 1935, showed that the assessee's statement was not correct. On 15th May 1935 the Income tax Officer called upon the assessee to prove his allegation. On 29th May 1935 the assessee's auditors wrote to say that the assessee could not prove the allegation and that it might be verified by a reference to the Income tax Officer, Moulmein. On 30th May 1935 the Income tax Officer told the assessee, by a letter, that his allegation had been found to be incorrect, that the amounts in question had been treated as the assessee's surplus capital and that it was open to him to explain his position with such documentary evidence as he might possess. On the 13th July 1935 the assessee wrote to the Income tax Officer saying that the interest had been assessed in the hands of the alleged payees *by the* Income tax Officer, *Thaton area* (Burma). The Income tax Officer doubted the *bona fides* of the explanation as the alleged payees were supposed to be assessees on the file of the Income tax Officer, Moulmein (Auditor's letter dated 29th May 1935) and could not therefore have been assessed by the Income tax Officer, Thaton. He thereupon reserved the case for further investigation. Early in 1936, an additional Income tax Officer was appointed to deal with cases pending under Section 34 at Karaikudi. He took up the investigation of this case and issued a memorandum to the assessee on 18th July 1936 stating that he proposed to complete the proceedings after giving him a final hearing and asking the assessee to appear before him on 24th July 1936 with all account books and pass books for his bank accounts. The assessee appeared on 23rd July 1936 (a day previous to the date fixed) and also on 28th July 1936 and 29th July 1936. The books and the other evidence produced by the assessee were scrutinised by the Income tax Officer at great length. This detailed scrutiny revealed the existence of several other sums of money belonging to the family which had been kept out of the accounts relating to the year of account and also subsequent years and which had presumably been earning interest elsewhere. The following instances were brought to light:—

- (i) During the year 1931-32 (which was the 'previous year' for the assessment under consideration) sums aggregating nearly Rs. 3,20,000 were found credited for the first time in the books in the names of the deceased mother and deceased wife of the assessee

and of five other persons belonging to the Pudukotta State. In the next year (1932-33) these sums were transferred to the assessee's personal account. It was vaguely explained that the sums belonged to the ladies of the family who had lent them to other persons and realised them during the year of account. There was no evidence to support this explanation and the Income tax Officer refused to accept it. He held that the money belonged to the family and must have been earning interest although not entered in the accounts.

(ii) Various sums belonging to the family were found to have been invested in the names of others, including Valayapatti R.M.A.P.R. and R.M.K.T. already referred to. These were also transferred to the assessee's personal account in 1932-33. The assessee's explanation was that the money belonged to the persons in whose names it stood and that he transferred it to his personal account in order to utilise it for charity in anticipation of their permission. The Income tax Officer considered this story to be fantastic and held that the money really belonged to the family.

(iii) Certain investments in the *vilasams*, A.L. S.V. and O.S.V., were said to belong to the ladies of the assessee's family. He expressed his inability to produce accounts to substantiate his statement. The Income tax Officer therefore concluded that these were further instances of money belonging to the family, but shown in the names of other persons.

(iv) A sum of Rs. 31,000 credited in the account of the assessee's son in 1934-35 was stated to have been received from one Ahmed Sulaiman Jeeva. No evidence was produced to show that it was in fact received from A.S. Jeeva. The Income tax Officer thought that the money belonged to the family and was brought into the accounts for the first time in 1934-35 having been kept out of the accounts prior to that. He accordingly held that this sum had been omitted from the accounts of 1931-32.

(v) In the account books of M.R.M. Myitkyo, certain deposits in the means of Kandanur P.S.V.M. and P.A.L.V. VR. were shown as repaid in *Ani of Prajothpathi* (June 1931) by the assessee's son Muthappa Chettiar. As there was no evidence to show from what source he got the money for the repayment of these debts, the Income-tax Officer held that it must have come out of certain secret funds of the family which had not been brought to account.

For these reasons the Income-tax Officer rejected the accounts as incomplete and unreliable and estimated the income from money-lending at Rs 55,000.

5. The assessee's appeal to the Assistant Commissioner against the assessment was unsuccessful. He then requested my predecessor to state a case to the High Court under Section 66 (2) of the Act. My predecessor declined to do so on the ground that no question of law arose. Copies of the orders of the Income-tax Officer, the Assistant Commissioner and my predecessor are filed, marked Exhibits A, B and C respectively.

6. The assessee thereafter moved the High Court under Section 66 (3) of the Act, and the High Court by its order dated 13th October 1937 has directed me to state a case and refer the following question, which I accordingly refer, for the decision of the Hon'ble Judges of the High Court:—

“Where the Income-tax Officer has issued a notice under Section 34, can he, for the purpose of assessing income which has escaped assessment rely on facts which come to his knowledge after one year from the end of the year of assessment?”

7. Section 34 authorises the Income-tax Officer in any case in which he believes that income has escaped assessment or been assessed at too low a rate in a particular year to serve on the assessee within one year of the end of that year a notice containing all or any of the requirements which may be included in a notice under Section 22 (2) of the Act. Having served the notice within the prescribed time, the Income-tax Officer may thereafter proceed to assess (or re-assess) the income, profits or gains, and the provisions of the Act shall, so far as may be, apply accordingly as if the notice were a notice issued under Section 22 (2). Thus in any assessment proceedings under Section 34, after the service within time of the initial notice calling for the return, the Income-tax Officer has power to do all or any of the things that he is empowered to do in any original assessment proceedings initiated by the service of a notice under Section 22 and not under Section 34.

8. When an assessment proceeding is started within time under Section 22 (2) all that can be expected of the Income-tax Officer is that he should have reason to believe that the income of the person to whom the notice calling for the return is addressed is such as to render him liable to income-tax. Similarly when an assessment proceeding is started within time under Section 34 the Income-tax Officer is expected to act in the belief that the person's income has wholly or partly escaped assessment or been

assessed at too low a rate. The Income-tax Officer cannot, in the nature of things be in possession of all the facts pertaining to the assessee's income or the extent to which it had escaped assessment. After the service of the notice under Section 22 (2) or Section 34 as the case may be, the Act provides that the Income-tax Officer should proceed to determine the person's income, and for this purpose he has power to call for accounts under Section 22 (4), and where a return has been made which the Income-tax Officer believes to be incorrect or incomplete, to hear such evidence as the person may produce and such other evidence as the Income-tax Officer may require *vide* Section 23 (2) and 23 (3).

9. In the final determination of the income the Income-tax Officer shall proceed under Section 23 (3) or, if any of the defaults described in Section 23 (4) has been committed, under that subsection. An assessment under Section 23 (3) must be made after hearing evidence and under Section 23 (4) to the best of the Income-tax Officer's judgment. In either case the Income-tax Officer must take notice of facts which come to his knowledge relevant to the nature and quantum of the person's income. The facts may well be facts brought to the knowledge of the Income-tax Officer by the assessee himself, and in all cases where the assessment is based on accounts the facts relied on by the Income-tax Officer are only those supplied by the assessee. Such facts obviously can come to the Income-tax Officer's knowledge only after the assessment proceedings have been started, and, as no time limit is laid down in the Act within which an assessment including an assessment under Section 34 must be completed, these facts may be furnished by the assessee even after the year to which the assessment relates or the year within which the assessment proceedings had to be commenced. When facts relevant to an assessment proceeding are produced by an assessee before the Income-tax Officer in the course of that proceeding the assessee has the right to demand that the Income-tax Officer shall take cognizance of those facts. It would be stultifying the statutory requirements of Section 23 (3) of the Act if he were to put such facts out of consideration. No time limit having been prescribed for the completion of assessments the only answer that can be given to the question propounded is that if facts that come to the Income-tax Officer's knowledge after the period of one year but before the assessment or re-assessment is completed afford evidence in respect of the assessee's income the Income-tax Officer can make use of them for the purpose of completing the assessment or re-assessment. I venture to

submit that when it is open to an Income Tax Officer to make use of facts supplied by the assessee right up to the time that the assessment proceedings are completed it must be equally open to him to make use of facts which he learns from others and not from the assessee before the completion of the assessment."

K. Rajah Aiyar, for the Assessee.

M. Patanjali Sastri, for the Commissioner.

SIR LIONEL LEACH, C. J.—On 18th November 1932 E. M. Visvanathan Chettiar was assessed to income-tax on an income of Rs. 3,277 in respect of the Tamil year ended 12th April 1932. The assessee was managing member of an undivided Hindu family. The family carried on a money-lending business at Pudukkottai in British India, in the Federated Malay States and in Burma. The year of assessment closed on the 12th April 1933 and on the 13th December 1933 the Income-tax Officer having reason to believe that income earned during the accounting period has escaped assessment issued a notice under Section 34 of the Indian Income tax Act. On the 6th October 1934 the assessee filed a statement to the effect that no income had escaped assessment. On the 25th February 1935 the Income-tax Officer issued a notice to the assessee under Section 23 (2) to produce the evidence on which he proposed to rely. On the 18th July 1936 the Income-tax Officer gave the assessee notice that on the 24th of that month he would commence an inquiry into the question of what income had escaped assessment and directed him to appear before him with all his account books and pass books. The inquiry in fact actually commenced on the 23rd July and continued on the 28th and 29th when it was completed. On the 30th July 1936 the Income-tax Officer re-assessed the assessee on an income of Rs. 55,000 which included the Rs. 3,277 already assessed.

The reasons for the delay which took place after the issue of the notice under Section 34 on the 13th December 1933 are apparent from the facts set out in the statement made by the Commissioner of Income-tax in making the reference now before us. Inquiries had to be made in Burma and there was lengthy correspondence with the Income-tax Officials in that country. It is clear that income which should have been assessed in the year of assessment did escape assessment. The assessee, however contended before the Commissioner of Income-tax that the Income-tax Officer had no right in making the further assessment to take into consideration information which he had received after the expiration of the year from the end of the year of assessment. The

Commissioner was asked to state a case on this point, but as he refused, the assessee applied to this court and the Commissioner was directed to refer the following question :—" Where the Income-tax Officer has issued a notice under Section 34, can he, for the purpose of assessing income which has escaped assessment rely on facts which come to his knowledge after one year from the end of the year of assessment."

As in our view the assessee wishes us to read into Section 34 something which is not there I will set it out in full. " If for any reason income, profits or gains chargeable to income-tax has escaped assessment in any year or has been assessed at too low a rate, the Income-tax Officer may, at any time within one year of the end of that year, serve on the person liable to pay tax on such income, profits or gains, or in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of Section 22 and may proceed to assess or re-assess such income, profits or gains and the provisions of this Act shall, so far as may be apply accordingly as if the notice were a notice issued under that sub-section :

Provided that the tax shall be charged at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be."

It will be seen that all that the section says is that if for any reason income chargeable to income-tax has escaped assessment in any year or has been assessed at too low a rate the income-tax Officer may within the time specified serve on the assessee the contemplated notice, and after having done so proceed to assess or re-assess such income. There is nothing in the section which indicates that the inquiry is to be limited in time.

The decision of the Privy Council in the case of *Rajendra-nath Mukherji v. Commissioner of Income Tax, Bengal*, has bearing on the question now before us. The assessee in that case were partners in a firm. After the year of assessment had expired but before the final assessment was made the Income-tax Officer discovered profits which had not been returned and at a period considerably later than the end of the financial year made an assessment based on what he had discovered after its close. The appellants submitted that on a true construction of the Act an assessment must be completed within the year of assessment and if it was not, the only remedy open to the Income-tax Authorities was that provided by Section 34. Their Lordships held that there

was no limitation to the time in which the final assessment could be made and that as proceedings for the assessment of the assessee's income for a financial year were pending and no final assessment had been made there was no question of income having escaped assessment within the meaning of Section 34 so as to make the service of a notice within one year of the end of the year as therein required a condition of assessment.

In the present case the notice required by Section 34 was given within the period allowed and it was the duty of the Income-tax Officer to ascertain what income had in fact escaped assessment. The assessment was re-opened so far as such income was concerned. To say that the Income-tax Officer shall be limited to facts discovered within a year of the year of assessment is to say something which the section does not say and if acted upon would defeat the object of the section. We have no hesitation in answering the reference in the affirmative.

The reference having been decided against the assessee he will pay the costs, Rs. 250.

Question answered in the affirmative.

[IN THE CALCUTTA HIGH COURT.]

In the matter of MESSRS. CHOUTHMAL GOLAPCHAND.

SIR HAROLD DERBYSHIRE, C. J. and COSTELLO, J.

July 21, 1938.

LOSS—SHARES—VALUATION AT COST PRICE AT THE END OF EVERY YEAR AND BEGINNING OF NEXT YEAR—DISSOLUTION OF FIRM—PARTITION OF SHARES AT VALUATION AGREED TO BETWEEN PARTNERS—DIFFERENCE IN COST PRICE AND PRICE FIXED—WHETHER ALLOWABLE AS LOSS—VALUATION OF STOCK—CHANGE OF SYSTEM OF ACCOUNTING—PRINCIPLES—INCOME TAX ACT, Sections 13, 24.

The assessee carried on a business in shares and held at the beginning of the accounting year 1935-36 an opening stock of shares valued at the cost price of Rs. 85,331. On March 9, 1936 in pursuance of an agreement entered into on January 8, to dissolve the firm on and from March 30, 1936, the above mentioned shares were allowed to the several partners at a valuation (alleged to be the market price) which was agreed upon by the partners, namely Rs. 51,966. The assessee claimed in 1936-37 that the difference between

these two figures, namely, Rs. 33,365 was a loss in the share business and should be set off against their income from other sources. It was found that the shares were acquired some years before the account year at a price higher than the ruling market price in March, 1935, and that they had been carried forward from year to year at the cost price. The assessee had also not made any application for changing their method of accounting : Held, on a reference, that as there was nothing to show that loss had occurred in the year of account the set-off could not be allowed. Further, as the assessee had adopted the system of valuing the shares at cost price at the end of every year and opening of the next year the cost price of the shares must be taken to have been their value at the beginning of the account year, the partition did not amount to a sale of the shares and there was no evidence of any loss. Every year is a self-contained period and the profits earned or the loss sustained either before or after that year are not at all relevant for the purpose of an assessment relating to a particular year.

Per COSTELLO, J.—If shares are put into the accounts at cost they must be taken out of the accounts at cost.

Cases referred to :

COMMISSIONER OF INCOME TAX, BOMBAY *v.* AHMEDABAD NEW COTTON MILLS Co. LTD. [1930] (57 I.A. 21 ; 54 Bom. 213 ; 4 I.T.C. 245).

COMMISSIONER OF INCOME TAX, CENTRAL PROVINCES & BERAR *v.* SIR S. M. CHITNAVIS [1932] (59 I.A. 230 ; 28 N.L.R. 205 ; 137 I.C. 772).

COMMISSIONER OF INCOME TAX, MADRAS *v.* CHENGALVARAYA CHETTY [1925] (2 I.T.C. 14 ; 48 Mad. 836).

SPANISH PROSPECTING Co. LTD., *In re.* [1911] (1 Ch. 92).

TATA INDUSTRIAL BANK LTD., *In re* [1922] (46 Bom. 567 ; 1 I.T.C. 152 ; 66 I.C. 1979).

Case stated by the Commissioner of Income Tax, Bengal, under Section 66 (2) of the Indian Income Tax Act in the matter of the assessment of the firm of Chouthmal Golapchand.

CASE.

“The following case is referred to the High Court in accordance with the provisions of Section 66 (2) of the Indian Income-tax Act, 1922.

Facts of the Case.—The assessment in question is for the year 1936-37 and was made on the income of the accounting year 1992 Ram Navami which ended on the 30th March 1936. During the accounting year the assessee Messrs. Chouthmal Golapchand were a firm of four partners with equal shares constituted under a partnership deed, dated 1st May 1933. By a deed of agreement, dated the 8th January 1936 the partners agreed to dissolve the firm on and from the 30th March 1936 (*Chaiti Sudi* 8, 1933) “and in the meantime to partition the assets of the partnership in so far as they are collected in equal shares and complete the partition.” A copy of this agreement is attached as Annexure A. (It is dated 8th January 1935, but this is admitted to be a mistake for 8th January 1936). The partition was completed on the 29th March 1936.

3. For the 1936-37 assessment the assessee, who had business in piece-goods, jute, money-lending, silver and shares and had also income from interest on securities and dividends returned against the head ‘business, trade, etc.’ loss of Rs. 16,285-6-3 and against the head dividends from companies, income of Rs. 1,389-12-0 thus returning a total loss of Rs. 14,895-10-3. The loss shown against the head ‘business’ included an alleged loss of Rs. 33,365 in the share account. The facts regarding this share account are that the assessee were doing business in shares and held at the beginning of the accounting year an opening stock of shares valued at cost Rs. 85,331. Their stock of shares had always been valued at cost. During the year there had been no transaction in shares. On the 9th March 1936 in the course of the partition above mentioned the shares were allotted to the four partners at a valuation agreed upon by the partners. The allotment was as follows:—

(Small amounts of cash were paid to make up the differences in the allotment):—

	Rs.
Rughlal Sohanlal	13,415
Sujanmull Punamchand	12,904
Hazarimull Sumermull	12,964
Melapchand Jatanlal	12,683
Total	Rs. 51,936

Rs. 33,365 which was the difference between this figure and the opening stock valuation Rs. 85,331 was claimed as a loss in the assessment. The Income tax Officer refused the claim on the ground that if there were any loss it was a capital loss on

distribution of assets. A copy of the assessment order is attached as Annexure B.

4. The status of the assessee for assessment purposes was also in question. Hitherto they had been assessed as a registered firm (Section 26-A of the Income-tax Act) and they applied orally for renewal of the registration for this assessment. The Income tax Officer when making the assessment on the 9th December 1936 refused to renew the registration on the ground that the partnership constituted by the deed of 1st May 1938 had been dissolved and no fresh deed had been executed. He made the assessment on an unregistered firm.

5. On appeal the Assistant Commissioner upheld both the disallowance of the claim for loss in shares and the rejection of the application for renewal of registration. Copies of his appellate orders are attached as Annexures C-1 and C-2. Being dissatisfied with these orders the assesseees have asked me to refer two questions (attached as Annexure D) to the High Court. I refer the following questions:

(a) Whether on the facts of this case the assesseees were entitled to claim a loss in shares by valuing the shares at their market price on the date on which they were divided up amongst the partners?

(b) Whether the Income tax Officer was justified in refusing to renew the registration of the firm?

6. With regard to the first question, the transaction was merely a distribution of assets and not a transaction in the course of business from which a revenue profit or loss could result. And the figure of loss arrived at is purely fictitious and arises from a change in the assessee's method of accounting which they are not entitled to make. No loss was in fact incurred on these shares and according to the assessee's method of accounting there could be no loss until the shares were sold. The division of the shares amongst the partners was certainly not a sale. In my opinion therefore the first question should be answered in the negative.

7. With regard to the question of registration, Income tax Rule 6 requires an application for renewal of registration to be accompanied by a certificate that the constitution of the firm as specified in the instrument of partnership remains unaltered. No such certificate was filed in this case nor could it have been since the firm was dissolved at the time of the oral application for registration. And the Income tax Officer could not renew the registration

of a firm which had ceased to exist. In my opinion therefore the second question should be answered in the affirmative ”.

ANNEXURE A.

Deed dated 8th January 1935 (actually of 8th January 1936).

This agreement dated the 8th day of January 1935 made Between (1) Rughlal Auchalia and Sohanlal Auchalia constituting a Mitakshara Hindu Family of the first part; (2) Surajmull Auchalia, Punamchand Auchalia and Bridhichand Auchalia constituting a Mitakshara Hindu family of the second part; (3) Hazarimal Auchalia, Surajmal Auchalia and Jananmal Auchalia Hindu Family of the third part: and (4) Jatanlal Auchalia as the *Karta* of the Mitakshara Hindu Family consisting of himself and his minor sons of the fourth part: Whereas by an Indenture of partnership dated the 1st day of May 1933 the parties hereof of the four parts continued to carry on the partnership business Messrs. Chouthmal Golapchand as equal partners in terms of a preceding partnership deed dated the 19th June 1927: and whereas the said parties of the four parts for various reasons decided to dissolve the partnership and partition the assets of the business: Now this Agreement witnesseth that the parties have agreed to dissolve the partnership on and from *Chait Sudi* 8 of 1933 corresponding to 30th March of 1936 and in the meantime partition the assests of the partnership in so far as they are collected in equal shares and complete such partition on the said date *Chait Sudi* 8 of 1933 and that in any case even though the actual act of partition be not complete within that date for non collection or non-payment of all outstandings or for any other similar reason the partnership agreement shall cease on that date *Chait Sudi* 8 of 1934 and shall not continue for any reason whatsoever.

It Witnesseth Thereof the parties have signed this agreement the date and year first above written.

Mr. Bose, for the Assesseees.

Dr. R. B. Pal, for the Commissioner.

DERBYSHIRE, C. J.—The facts in this case are set out in the case and in Annexure A, dated January 8, 1936.

The first question is whether on the facts of this case the assesseees were entitled to claim a loss on shares by valuing the shares at their market price on the date on which they were divided up amongst the partners?

It has been contended by the assesseees that these shares were sold by the partnership to the outgoing partners, and not partitioned as the case states. The case, in my opinion, is in accordance

with the facts and is conclusive on that point. The shares in question were acquired sometime previous to the beginning of the accounting year, we are not told how long previous. It is common ground that they were acquired at a price higher than the price ruling on March 8 or March 30, 1936. They had been shown in the books of the partnership and carried forward from year to year at the cost price.

The assessees say that there was properly a loss on the disposal of those shares and that that loss was the difference between the cost price and price at which they are taken over which is alleged to be the market price on March 8, 1936. The assessees say that that loss they are entitled to set off against gains on other parts of the business during the accounting year.

We are not told what the market value of these shares was at the beginning of the accounting year in question. It is only the loss during the year that can be set off against other gains during the year. We do not know what loss, if any, occurred on these shares during the accounting year in question. It was pointed out by Lord BUCKMASTER in the case of *Commissioner of Income tax, Bombay Presidency v. Ahmedabad New Cotton Mills Co. Ltd.* (L.R. 57 I.A. 21 at page 23) where the question of the valuation of stocks in relation to the ascertainment of the profits of a business for a particular year was discussed that "Section 13 of the Indian Income Tax Act, 1922 says: "Income, profits and gains shall be computed for the purposes of Sections 10, 11, and 12 in accordance with the method of accounting regularly employed by the assessee". He also says: "The method of introducing stock into each side of a profit and loss account for the purpose of determining the annual profits is a method well understood in commercial circles and does not necessarily depend upon exact trade valuation being given to each article of stock that is so introduced. The one thing that is essential is that there should be a definite method of valuation adopted which should be carried through from year to year, so that in case of any deviation from strict market values in the entry of the stock at the close of one year it will be rectified by the accounts in the next year".

In my opinion, as this stock was at all previous times valued at cost price and was brought into the balance-sheet at the beginning of the year at its cost price, then when it was taken out of the assets of the company, it also should be valued in the same way at the cost price. The system of valuation which the assessees contend for would, it appears to me, have the effect of bringing

into the accounts of the year a loss in respect of this stock which had not occurred during the year. For these reasons I am of the opinion that Question (a) should be answered in the negative.

As to Question (b) the partnership in question had come to an end on March 30, 1936, by virtue of the deed of dissolution. The deed provides that the partnership agreement shall cease on that date and "shall not continue for any reason whatsoever". Therefore, on December 9, 1936, when the Income-tax Officer refused to renew registration of the firm, the firm no longer existed in any way and could not be deemed, to use the words of the deed, to "continue for any reason whatsoever": that includes continuation for purposes of registration under the Income-tax Act. In my opinion Question (b) must be answered in the affirmative.

The Commissioner is entitled to the taxed costs of this Court including the fees of two advocates.

COSTELLO, J.—The assessment with which we are concerned was made on December 9, 1936, the year of assessment being 1936-37, that is to say, it was made in respect of the period from March 31, 1935 to March 30, 1936, which is the *Ram Navami* year of the firm.

The assessee is described as an unregistered firm and there were four partners each of them having one-fourth share in the firm. The assessment was made under Section 23 (3) read with Section 25 (3). The assessee had submitted a return in response to notices under Section 23 (2) (sic) and Section 22 (4) (sic). In that return in respect of their share business or as it was called in the assessment "shares account" they have claimed to be allowed to deduct a loss of Rs. 33,865 said to have been incurred in respect of the sale of certain shares which constituted part of their stock-in-trade.

It has been argued before us that the matter has to be determined with reference to Sec. 24 (1) of the Income-tax Act which says: "where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Sec. 6, he shall be entitled to have the amount of loss set off against his income, profits or gains under any other head in that year."

The contention put forward on behalf of the assessee was that the shares in question had originally cost Rs. 85,831 and that was the figure which had appeared in their accounts apparently on more than one occasion, and certainly at the opening of the accounting year, the tax year 1932. It was then said that upon the dissolution or rather, in contemplation of a dissolution of the

partnership as provided for in an agreement dated January 8, 1936 these shares were disposed of (for the moment I use a neutral word) and had produced the sum of Rs. 51, 66—showing the difference between that sum and the cost price—a sum of Rs. 33,365 which I have mentioned. The case as originally put forward by the assesseees is to be found set forth in the decision—the appellate order and ground of decision as it is called—of the Assistant Commissioner given on February 12, 1937 in which he said :

“ The learned pleader has tried to argue that there was an actual sale of the shares as between the partners. I am afraid that I cannot accept this contention, for, as a matter of fact the books show that the partners’ accounts were debited with the value of the shares allocated to each of them and that there was a payment of small amount of ready cash to make up the small difference which arose from the distribution of the shares.”

The learned Assistant Commissioner further said :

“ The reason for the Income-tax Officer not allowing the loss on shares I find, was due to the fact that he found that there was no actual sales of shares in the year of account, and that the business having been discontinued, the assets were distributed among the partners who received an allocation of shares which were priced at one ruling market rate.”

Apparently, the assesseees endeavoured to induce the Commissioner of Income-tax to put a question of law before this Court in a form which would suggest that there had actually been a sale of the shares in question, because we find that the question of law dated April 26, 1937, as formulated by the assesseees was as follows :

“ Where the partners of an assessee firm having share business agreed on 8th January 1936, to dissolve the firm on 30th March 1936 and in the meantime realise the assets thereof and divide the proceeds amongst themselves and where for that purpose the stock of shares was sold by the firm at market rate resulting in a loss of Rs. 33,365 as the market rate was very much lower than the cost price, whether in assessing the firm the Income-tax Officer is competent in law to disallow such loss as capital loss only arising out of alleged allocation of shares as stranger buyers having not been obtained on suitable terms for depressed market the shares were sold to the four new firms of the families of the partners started after the said date—8th January 1936 ”.

This seems to indicate to my mind that the assesseees in some way anticipated that they would find themselves in difficulties if

they came before this Court in the position of having to found an argument upon a set of facts which included in it a statement that the shares were actually divided up or shared out or distributed amongst the four persons who originally composed the partnership. It is obvious, to my mind, that the question formulated by the assesseees was intended to suggest, and in fact did suggest, that there had been an actual sale of the shares to third parties in the shape of new firms and that the old partners had then distributed amongst themselves the proceeds of that sale. We find, however, that even as far back as the assessment to which I have already referred, the Income-tax Officer himself took an entirely different view and he said, commenting on the shares account :

"There was no sale in the year of account. The business has been closed and assets have been transferred to the partners at alleged market price. Shares were purchased at a time when prices were rather high and the assessee has all along valued his closing stocks at cost price. Due to over-valuation of the opening stock for the same reason the assessee is claiming losses as above. It is due entirely to depreciation in the capital value of shares held and as there was no sales I disallow the claim".

When the assesseees had succeeded in persuading the Commissioner of Income-tax to put the matter before this Court in the case which the Commissioner put forward we find it stated :

"The facts regarding this share account are that the assesseees were doing business in shares and held at the beginning of the accounting year an opening stock of shares valued at cost Rs. 85,331. Their stock of shares had always been valued at cost. During the year there had been no transaction in shares. On the 9th March 1936 in the course of the partition above mentioned the shares were allotted to the four partners at a valuation agreed upon by the partners."

Then he sets out the values assigned to the shares and explains that small amounts of each are paid to make up the differences in the allotment. He had previously stated that the partition was completed on the 29th March, 1936.

It may be said at the outset that there can be no doubt that business firm which is liable to be assessed to income-tax is under an obligation to maintain a system of accounts with regularity and it is not permitted to change the system except upon a proper application being made to the Income-tax authorities in that behalf. We find it laid down in paragraph 51 (ii) of the Income-tax Manual as follows :

“The cases in which an assessee desires to change his accounting system should be rare and where such a request is made, the Income-tax Officer in considering it should, as in the similar case of a demand for a change in the ‘previous year’ if he is prepared to allow the change, take steps to secure that no profits escape taxation on account of the change. While Sec. 13 leaves it to the discretion of the Income tax Officer to decide whether a particular system of accounting should be allowed, the discretion of the Income-tax Officer in this matter can be questioned in the course of an appeal against an assessment under Sec. 30, that is, it may be made one of the grounds of appeal in contesting the assessment of profits.”

In the case now before us no application was made to change the accounting system and, in fact, no change was made. We find, as I have already stated, that at the beginning of tax year 1922 (Ramanavami) the value of these shares was put in the accounts of the firm as at the cost price. There is another rule which is of great importance in a matter of this kind and that is that every tax year is a self contained period and the profits earned or the loss sustained either before that year or after that year are not at all relevant for the purpose of an assessment relating to a particular year. In that connection I must briefly call attention to the case of *Commissioner of Income-tax, Central Provinces and Berar v. Sir S. M. Chitnavis*, in which at page 296 Lord Russell of Killowen, delivering the opinion of the Board said:

“Although the Act nowhere in terms authorises the deduction of bad debts of a business, such a deduction is necessarily allowable. What are chargeable to income-tax in respect of the business are the profits and gains of a year; and in assessing the amount of the profits and gains of a year account must necessarily be taken of all losses incurred, otherwise you would not arrive at the true profits and gains. But the losses must be losses incurred in that year. You may not, when setting out to ascertain the profits and gains of one year, deduct, a loss which had, in fact, been incurred before the commencement of that year. If you did, you would not arrive at the true profits and gains of the year. For the purpose of computing yearly profits and gains each year is a separate self-contained period of time in regard to which profits earned or losses sustained before its commencement are irrelevant.”

Then in a subsequent paragraph at page 297 Lord Russell said:

“Whether a debt is a bad debt, and, if so, at what point of time it became a bad debt, are questions which in their Lordships’

view are questions of fact to be decided in the event of dispute by the appropriate tribunal, and not by the *ipse dixit* of any one else."

Lastly at page 299 the noble and learned Lord said :

"In their Lordships' opinion the question which was referred to the Court in relation to bad debts should have been answered as follows: 'The assessee has no 'option' of declaring debts bad; whether a debt is bad, and when it became bad are questions of fact to be determined in case of dispute not by the assessee or by the exercise of any 'option' on his part, but by the appropriate tribunal upon a consideration of all relevant and admissible evidence.'

* * * *

In the same way, in my opinion, it follows that it is not open to an assessee by his own *ipse dixit* to decide that a particular transaction entails loss of a kind which may be set off against profits or gains made in respect of other transactions. In this particular instance these assessees were asking the Court to hold that because the shares in question were bought at one price and then dealt with on the basis of another and lower price, that was necessarily a business loss of the kind contemplated by Section 24. As it was the practice of this firm, or apparently was the practice to put in the value of that part of their stock in trade which consisted of shares—equally with the rest of their stock in trade—at cost price at the end of one accounting year and at the opening of the next, it follows from what I have already said and the authority to which I have referred that the cost price of the shares must be taken as the starting point or, as I called it in the course of argument, the datum line for the purpose of ascertaining whether or not there has been an increase or a decrease in the value of the shares in question.

It is quite certain and, indeed, it is clear law that if a trader puts into his accounts one value at the end of any accounting year, he must start his next year's accounts with precisely the same value. In this connection I would mention the case of *Commissioner of Income-tax, Madras v. Chengalvaraya Chetty and Munisami Chetty*. Having put in the value of these shares as at cost and being in the position that they were not able, and in fact did not seek, to change the system of accounting in this particular case, we must take the cost price of these shares as the starting point. It seems to me, therefore, that if there had been any real sale of these shares in the course of the year 1992 (Ramanavami)

it might have been open to the assesseees to say that it was between the cost and the sale price that there was this difference of Rs. 33,365. But there never was a sale. It is quite obvious, and in any event we must accept the statement of facts put before us by the learned Commissioner, that there was no sale, but what was loosely called a 'partition'. I say loosely because 'partition' in this country is a technical expression which has in it implicit number of legal ideas and legal consequences which are not applicable in a case of the kind we are now considering. Therefore, I prefer to say that there was a division of these shares and that division took place, as the learned Commissioner states, on March 9, 1936. The partners for their own purposes chose to say that they would take over the shares or rather their portion of the shares. What they said as regards a loss seems to me to be definitely an *ipse dixit*. They have sought to take credit to themselves—credit in its commercial sense—for the difference between the buying and the selling price based upon a valuation which they themselves had chosen to put upon these shares and in regard to which, as far as one can see, there was no evidence as to its accuracy.

In these circumstances, the matter seems to me to fall well within the ambit of the decision in the case of *In re The Tata Industrial Bank Ltd.*, the headnote of which runs as follows :

"A banking concern having been assessed for income-tax on profits amounting to Rs. 12,54,130 it claimed to deduct from the taxable profits a sum of Rs. 2,98,000 being the amount of depreciation on war bonds and securities belonging to the bank, arrived at by comparing the market rates with the valuations in the books of the bank."

That seems to me very much the same kind of operation as was performed or was sought to be performed by the assessee in the present instance. In the course of his judgment MAOLEOD C.J., discussed the case on which Mr. Bose relied in his argument before us, namely, that of *In re The Spanish Prospecting Company Limited* [(1911) 1 Ch. 92] where at page 98 FLETCHER MOULTON L. J., said :—

"The word 'profit' has in my opinion a well-defined legal meaning, and this meaning coincides with the fundamental conception of profits in general parlance, although in mercantile phraseology the word may at times bear meanings indicated by the special context which deviate in some respects from this

fundamental signification. 'Profits' implied a comparison between the state of a business at two specific dates usually separated by an interval of the year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates."

At page 99 the learned Lord Justice said :

"We start therefore with this fundamental definition of profits, namely, if the total assets of the business at the two dates be compared, the increase which they show at the later date as compared with earlier date (due allowance of course being made for any capital introduced into or taken out of the business in the meanwhile) represents in strictness the profits of the business during the period in question."

Now Mr. Bose at the opening of his argument invited our attention to that definition. It seems to me that in the present instance the assesseees have overlooked the fact that they were taxed in respect of trading operations for the period beginning on March 31, 1935 and ending on March 30, 1936. The 'self-contained period' referred to by Lord Russell in the passage which I quoted earlier in this judgment was the period between those particular dates. In other words, before the Ramanavami year 1992 had come to an end part of the assets of the business had been taken out of the business, namely, these particular shares which as we have seen, were distributed amongst the four partners on March 9, 1936. That is one way of looking at it and upon that view of the matter there could be no question of loss, because you cannot compare anything that happened when the shares were disposed of as against the cost price of those shares as appearing in the opening stock account at the beginning of the Ramanavami year 1992. I entirely agree with the view put forward by my Lord, the Chief Justice, with regard to that.

Looking at the matter from the other aspect which I have discussed, it seems to me that the assesseees were not entitled to say 'we have shown the value of these shares year after year as at cost price: we now propose to show the value of them as at the market price.' To state the matter succinctly, I agree that if these shares were put into the accounts at cost they ought to have been taken out of the accounts at cost.

It follows, therefore, that the first question propounded for the consideration of this Court should be answered in the negative. I need say very little with regard to the second question. In my opinion, merely to state that the application was made in December and the partnership had been dissolved, and irrevocably dissolved, as on the 30th of March 1936 is quite sufficient to indicate that the answer to that question should be in the affirmative.

Reference answered accordingly.

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